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ABSTRACT

Papers in these proceedings are grouped under the following headings: addresses, entrepreneurship, entrepreneurship education, free market economics, public policy, and economic education. Papers include "Economic Freedom and Private Enterprise" (Murray L. Weidenbaum); "Marxism and the Free, Capitalist Society" (Tibor R. Machan); "Knowledge, Ethics and the Case for a Free Market in Education" (John Gray); "Between Sterility and Dogmatism: The Morality of the Market and the Task of the Economics Teacher" (Paul Heyne); "Influences on Entrepreneurship" (Arnold C. Cooper); "Entrepreneurship: Some Recent Contributions in the Economics Literature" (Roland H. Koller, II); "Ideologies of Economics: Scientific Revolution and the Entrepreneur" (Felix R. Livingston); "Entrepreneurial Failures: Results from a Study of Business Bankruptcies in Minnesota" (Karl A. Egge); "Creating America: The Entrepreneurship of Beginning" (Gerald Gunderson); "Entrepreneurial Irruption in the World System" (Jared C. Lobdell); "Level of Personal Maturity Seen as Fuel for Entrepreneurial Spirit" (Robert N. Carter, Mark F. Hartley); "The Entrepreneurial and Collectivist Impulses: A Problem in Social Dynamics" (Dan C. Heldman); "Improving Student Attitudes toward Careers in Small Business Management" (Donald L. Brady); "The Educated Entrepreneurs" (Robert Ronstadt); "The Entrepreneurial Assessment Center" (Donald F. Kuratko, Ray V. Montagno); "Corporate Entrepreneurship: The New Educational Challenge" (Michael A. Evanchik, Rita Moore); "Owensboro Entrepreneurs Project" (Sally A. Asefa); "Exporters' Profiles and Export Constraints: A Study of Small and Medium Sized Firms in Minnesota" (Vivian Nazar); "Financial Analysis Made Easy: Using Financial Spreadsheets in Entrepreneurship and New Venture Courses" (George G. Eddy, et al.,); "School-Based Businesses in Georgia" (Elizabeth J. Gatewood, Paul F. DeLargy); "Adam Smith's 'Theory' of Investment in Human Capital" (Ronald Merchant); "Elements of a Free-Market Theory of Economic Progress" (Alan Rufus Waters); "All American Economics--Made in the U.S.A." (D. P. Diffine); "On the Role of the State in a Private Enterprise System" (Coldwell Daniel, III);

"Small Business and Regulation--Foe or Friend?" (George W. Rimler); "Privatization of Public Services: A Model Applied to Urban Transit" (Cliff Atherton, Duane Windsor); "National Emergency and Private Property Rights" (Robert Higgs, Charlotte Twight); "Lessons from the Redlining Debate" (F. Jerry Ingram); "The Privatization of Prisons: An Overview" (Eugene Garaventa); "Student-Teacher Characteristics and Economic Literacy: A Middle Grade Study" (Luther D. Lawson, Margaret G. O'Donnell); "National Survey of High School Economics" (Bob Figgins, Gary Young); "A Practical Integration of Supply-Side Economics with IS-LM for Intermediate Level Students" (John B. McCall); "A Lesson in International Economics" (Saul Z. Barr); "Entrepreneurship--The Difference between Economic Systems--Man's Material Progress" (Sandor Balogh); "Uncertainty and Planning Failure" (H. C. Li); and "Comparing State Support of Higher Education" (G. W. Parker, Dorothy Anderson). (Some papers are abstracted, while most are presented in their entirety.) (KC)

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THE ASSOCIATION OF
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This is the second issue of The Journal of Private Enterprise which is published by the Association of Private Enterprise Education (APEE). This Journal brings together scholars in the fields of Economics, Management, Entrepreneurship, Marketing, Finance, Ethics, Religion and Education who have done significant research on topics pertaining to the American system of private enterprise. These papers were originally presented at the Annual Conference of the Association of Private Enterprise held in San Antonio, Texas, April 6-8, 1986. Each presentation at that Conference was evaluated by members of the Editorial Board and selected other reviewers. Both full papers and abstracts of papers are presented in this volume. Those interested in receiving complete copies of the works abstracted in the Journal should directly contact the authors concerning their availability. It is the intention of the Association of Private Enterprise Education to issue the Journal at least annually.

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OF THE
ASSOCIATON OF PRIVATE ENTERPRISE EDUCATION

SAN ANTONIO, TEXAS
April 6-8, 1986

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CALL FOR PAPERS
TWELFTH ANNUAL INTERNATIONAL CONFERENCE
ASSOCIATION OF PRIVATE ENTERPRISE EDUCATION

THE WAVERLY
ATLANTA, GA
April 26-28, 1987

At its Twelfth International Convention this year, the Association of Private Enterprise Education will include sessions of juried presentations which will contain papers on a variety of topics pertaining to private enterprise, entrepreneurship, and economics education. All papers accepted for inclusion in the conference will be considered for publication in The Journal of Private Enterprise.

The Association is seeking papers on any topic which pertains to private enterprise, entrepreneurship, or economics education. Of particular interest are papers dealing with the history and philosophy of private enterprise as well as papers dealing with specific public policy issues as they impact the private enterprise system or entrepreneurship. Other areas of high interest to the Association include entrepreneurship and the privatization of public functions.

Included also in the convention are sessions on specific private enterprise, entrepreneurship, and economics education activities and programs. Submission of papers describing these activities and evaluating their effectiveness are solicited. As a means of informing educators of successful undertakings, highest consideration will be given to those papers which not only describe the project but document and evaluate its results.

Papers should be between ten and twelve pages of double-spaced manuscript with references and footnotes to be at the end of the article. Authors of papers accepted for inclusion in the conference program and in The Journal will be notified as to style requirements.

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REMINDER

TWELFTH ANNUAL INTERNATIONAL CONFERENCE OF THE ASSOCIATION OF PRIVATE ENTERPRISE EDUCATION

THE WAVERLY
ATLANTA, GA

April 26-28, 1987

* * * *

ECONOMIC FREEDOM AND PRIVATE ENTERPRISE

Murray L. Weidenbaum
Washington University in St. Louis

I am deeply honored to be the third recipient of the Adam Smith award of the Association of Private Enterprise Education. It is a special pleasure to learn that the previous recipient is a former colleague and longtime friend whom I admire, the Honorable James C. Miller III.

I often think of Jim these days because the air is full of sounds of budgets being cut and taxes being reformed. But as educators, it is useful to step back and ponder the fundamentals that underlie the heated debates of the moment.

When the frenetic events of the day are evaluated in the more leisurely light of history, I am confident that we will find that we have been engaged in an effort far more fundamental than raising the growth rate of the GNP or slowing the pace of the Consumer Price Index, worthy as these actions are.

The United States is currently making an unprecedented shift in the focus of economic decision-making, away from the federal government and to the many diverse and smaller organizations and institutions that serve individuals. Thus, it is not a question of whether it is more desirable to cut taxes or to reduce the growth of government spending, or to curtail government credit programs or to provide relief from regulatory burdens. All of these are part of a larger endeavor: to strengthen the performance of the private sector by reducing the power, the burden, and the obtrusiveness of the public sector.

This shift in national priorities is based on the general proposition that private citizens do not need government officials to make their decisions for them or to direct their daily lives. Most people--workers, managers, investors, buyers, and sellers--know what they want and how to obtain it. Over time, the aggregation of these individual actions generally results in the most appropriate distribution of our economic resources and the highest levels of well-being.

The best government economic policy, therefore, is the one that provides a stable environment in which private citizens can confidently plan and make their own commitments and choices. Those who advocate departures from this approach bear the burden of proof that government intervention will do more good than harm. Advocates of intervention must show in any given situation that "market failure" is greater than the "government failure" that usually accompanies political and bureaucratic responses to economic and social problems.

This, in my opinion, is a useful and succinct statement of the principles of limited government consistent with an economic order organized primarily on the basis of private enterprises competing in a market system. It is hardly new. Adam Smith came to this same conclusion over two centuries ago when he first conducted his inquiry into the nature and causes of the wealth of nations. The society he envisioned surely was not anarchic. Rather it was characterized by limited government, with the expectation that government would perform well the important tasks that only it could carry out, notably defense and those major public works we now call infrastructure. Unfortunately, many of us need to sift through the complications of current controversies and rediscover these fundamental truths.

Freedom and the Marketplace

Let us begin by looking at the basics of a free economy. It is a world where people sometimes win--and sometimes lose--in their economic pursuits.

Given adherence to mutually accepted rules, a free enterprise system teaches individuals how to avoid failure and pursue success. In a healthy market-oriented economy, individual entrepreneurs and companies that are efficient in meeting consumer needs are profitable. Those that fail to meet those needs, or do so at high cost, sustain losses. Thus it is erroneous to refer to a "profit" system; more accurately, ours is a profit-and-loss system. The opportunity to earn a profit is only as available as the possibility of bearing a loss.

Government institutions, on the other hand, are not subject to any such discipline. No federal agency ever has been forced to declare bankruptcy. Rather, the typical response for a federal department living beyond its budget is to urge the Congress to increase its use of public resources. Government programs often continue beyond their original justification and develop a life of their own. There is no shortage of critics who comment about the shortcomings of the "invisible hand" in the market economy. But, as we have learned so painfully and so often in recent years, the "fickle finger"--or rather the hard fist--of government usually generates far greater problems when it intervenes in economic decision-making.

The last half century provides an almost endless array of experiences with well-intentioned governmental interventions in private decision-making that did not work out. These examples of government failure range from the scandal-ridden Reconstruction Finance Corporation of the 1930's and 1940's to the waste-laden Office of Economic Opportunity of the 1960's and 1970's to the counterproductive farm subsidies of the Commodity Credit Corporation that have extended throughout the period.

It is not a question of altruism, but of enlightened self-interest, that motivates the individual and the business firm. A private enterprise system takes advantage of that fact. As Adam Smith put it, "it is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard of their own interest."

It is ironic to listen to thoughtless statements that free market institutions are heartless enough to let people starve. The fact of the matter is that the capitalist nations of the world are feeding the socialist nations--not on a purely charitable basis, but in the effective spirit of Adam Smith's baker.

The role of government in this context must be carefully defined. Let there be no misunderstanding of the true meaning of free enterprise. It does not mean being singlemindedly pro-business. That approach normally translates into a cozy partnership between government and business--subsidies and protection for failing industries, "incomes" policies, government planning, and other interventionist techniques usually justified on an "exceptions" basis.

Indeed, many day-to-day practices on the part of business executives merit our critical attention. We can begin with the very way in which the business community describes economic events. For example, employers rarely refer to competition in their labor markets. The more widely used term for other companies bidding away their workers by offering them higher wages and salaries is "pirating" employees. Similarly in product markets, competition is only favored in the abstract or in the case of potential suppliers to the firm.

We rarely hear the word competition used in the markets in which the company sells its goods and services. There, the preferred term is price "chiseling." That specifically refers to the ungentlemanly practice of lowering prices.

The expansion of foreign trade has given rise to its own specialized vocabulary. "Imports" is too technical a term for general business usage. More common is the phrase "unfair competition." The volume of foreign goods entering the U.S. is usually described as a "flood." And what is the desired response? Protection against imports is too blatant. "Fair trade" sounds much better. After all, it is only fair that we buy American-made products.

Protectionism is a politician's delight because it delivers visible benefits to the protected parties while imposing the costs as a hidden tax on the public. Some day the public will learn that too well kept secret -- that the higher prices that invariably result from protectionism are paid by American consumers. Ironically, in all too many cases, such as textiles and apparel, this burden hits most heavily on the poorest people in our country.

As an aside, it does little to bolster citizen confidence in a private enterprise system when captains of industry on one day urge people on welfare to stop depending on government for handouts and, on the very next day, appeal to that same government for some special benefit. Subsidy, of course, is a very selective term in business English. It usually is preceded by the word "farm."

Euphemisms are widely employed by corporate executives. Thus, in standard financial reporting, companies earn profits--a phrase that conjures up the notion of positive achievement of their own doing. In contrast, firms suffer losses. That sounds like an unexpected blow inflicted by some sinister force in the external environment beyond corporate influence.

By no means is the use of euphemisms limited to members of management. Take the example of the "corporate activists." Judging by their self-designated title, you would expect that corporate activists were engaged in the worthy enterprise of attempting to energize a sluggish company or were concerned with improving the economic performance of American business. Nothing could be further from the truth. The typical "corporate activists" are oblivious to the economic role of private enterprise. Producing and distributing the goods and services that meet consumers' needs is too humdrum a task to attract their interest.

Rather, they see the resources of the private enterprise system as a means for achieveing their social ends. One term they love to use is corporate or economic democracy. But, on the contrary, they refuse to abide by the decisions of this nation's democratic political processes. They will buy a few shares of stock in a company--not as an investment--but to use the annual meeting as an opportunity to try to force the company to follow their pet social or political goals. These are goals which they are unable to convince Congress to adopt--such as imposing our internal social standards on other countries.

Some unions and other activist groups favor such high-sounding phrases as "pay equity" and "comparable worth" to describe the effort to raise arbitrarily the salaries of some members of the workforce above competitive market levels. As economists, we know the sad results, as in public education where there are chronic surpluses of gym teachers amidst continuing shortages of math and science instructors.

Descriptions of comparable-worth systems remind me of the Middle Ages, when the priesthood sat in judgement on economic matters, depending on theological concepts to determine what they called the "just price." Activists today attempt to play a similar role, forgetful of the costly impacts of imposing dogma on a modern market economy.

Of course, the private sector did not invent obfuscation, nor are business executives its exclusive practitioners. We can recall the tale--perhaps mythical--of the federal inspector who examined two very similar rooms of government officials, neither of whom was working at the time. His report was simple and to the point: "duplication."

Actions and Appropriate Inactions

At times, adhering to the principles of economic freedom requires specific actions and on the other occasions it necessitates forebearance. For example, promoting the concept of free enterprise requires that no favored treatment be given to any specific interest group or industry. It means restraining the tendency to reallocate resources from those who are entitled to them by virture of their own ability to those who receive them by political fiat.

I still recall meeting in Washington with the representatives of an industry seeking a federal bailout. After I pointed out that such action was the economic equivalent of welfare, the chairman of the group responded with great indignation, "Why, Mr. Chairman, welfare is for poor people."

We academicians, of course, look at the world from our own vantage point. That is hardly unique. My concern is our unstated assumption that all others see the unfolding of events from that same viewpoint characterized by logic and consistency. That is hardly a universal phenomenon.

For example, economists may argue for a laissez-faire approach to hostile takeovers on the basis of free market principles. However, the heads of many large corporations see no problem in appealing to the federal government to intervene in their behalf. As a practical matter, they simply want to use the power of government to make it more difficult for "outsiders" to take over their companies. An extremely colorful vocabulary has developed in this sector of business: poison pills, junk bonds, shark repellants, wolf packs, white knights, greenmail, and golden parachutes.

There is no need to argue that all or even most takeover attempts are constructive--or even benign. What should concern the business proponents of more government intervention in private business decision-making is the array of effects that usually follow. The long and intricate history of government involvement in the private economy does not provide an inspiring basis for expanding the role of the federal government in corporate governance.

Whether that intervention is made by the judicial, legislative or executive branch, government regulation often does more harm than good. Study after study shows that much government regulation frequently fails to meet the most elementary benefit-cost test.

Moreover, economic history teaches us that government intervention usually begets more government intervention. In the present situation, for example, if government should limit the maneuvers by corporate raiders, that would tilt the balance of power. Invariably, it would lead to pleas to restrict the defensive actions of company managements (and vice versa).

Surely it is legitimate for well-financed groups of investors to attempt hostile takeovers of private companies. So, too, resistance by the target company's board of directors may be perfectly proper. To ascribe the public interest to just one side of the controversy is to ignore the fundamental role of competition in the marketplace.

Surely, leaders of the sectors of the economy also can be properly criticized for their intellectual shortcomings in dealing with important issues of public policy. An example is the inconsistent attitude of many proponents of government welfare programs. Especially in these days where virtually every federal agency's budget is being cut, we hear howls of outrage from the supporters of food stamps, medicaid, public housing and other so-called "payments in kind."

But how do these same advocates of higher federal spending reply when some of us raise the simple statistical notion that such "income in kind" should be included when the government attempts to measure the number of people in poverty? It is almost incredible, but the proponents of these expensive programs contend that such reporting would be unfair. And why? The formal reason given is not that such more comprehensive measures of income would reduce the clientele of the social welfare agencies. Such an unusual display of accuracy would constitute too self-serving and unattractive an argument. Rather, the proponents of the status quo point out that a dollar of spending for these social programs does not generate a dollar of benefit to the recipients. One enthusiast for these social programs admits that food stamps ". . . certainly aren't worth their face value in cash." He suggests that these items, should they be included in any measure of poverty, be discounted by 20% or even 40%.

The cynic in me says that we have the makings of a deal here. Eliminate food stamps and all other "payments in kind" and split the difference. Give the current recipients cash equal to one-half of the government's current cost for these programs and reduce the budget deficit by the other half! I readily forecast that the major complaints would not arise from the "clients" of these programs, but only from the newly unemployed social workers.

Our concern for the principles of economic freedom needs to be broad gauged. It cannot stop at the water's edge. Free-flowing international trade and investment--a free enterprise system writ large--offers greater economic welfare to people of all countries. The same specialization of labor and individual creativity that we see in our society can also be encouraged beyond our borders.

Special interests would have us close the door to the accomplishments of Japanese management, or to the natural abundance of French vineyards. But, when all the benefits of a more open economy are added up, it becomes clear that losses for domestic producers do not, and cannot, cancel out the gains that consumers receive from imports. Free trade, of course, must be a two-way street. To oppose protectionism here at home is proper but insufficient. We must also speak out just as strongly against restrictions on commerce imposed by other governments.

On reflection, some policy innovation may be useful; one was suggested a while ago by my favorite economic analyst, Russell Baker, the columnist for The New York Times. You may recall, back in 1981, the controversy about limiting the imports of Japanese cars. Baker, in his customary scholarly manner, examined the comparative advantages of both the United States and Japan. He found that the Japanese auto industry had productive capacity far in excess of its domestic requirements. Similarly, he noted that the United States was producing far more lawyers than we need.

Unencumbered by econometric analysis or weighty theory, Baker recommended a simple swap. For every 1,000 Japanese cars that enter the United States, we would send Japan 100 lawyers. He was not concerned about an ensuing flood of foreign-produced motor vehicles. Rather, he saw this type of tied trade as possessing self-limiting features.

As American attorneys entered the Japanese economy, he reasoned, that nation's productivity would erode. In contrast, the exodus of lawyers from the United States would contribute to a rise in the efficiency of our economy. Eventually, the economic competitiveness of the two nations would equalize. Baker felt so strongly about his plan that he suggested that we start the process by sending the Japanese 100 lawyers on the cuff!

The Costs of Economic Freedom

As in so much of life, there are real costs of achieving and maintaining important values such as economic freedom. Friedrich von Hayek has written eloquently on the neglected aspect of the relation between freedom and economics. In The Road to Serfdom, he cautioned with great foresight against the dangers of growing government. Even earlier, in a less often quoted work, he made a point that seems as appropriate to me now as it did to him then. In Freedom and the Economic System, he wrote: "Freedom and Democracy are not free gifts which will remain with us if only we wish it. The time seems to have come when it is once again necessary to become fully conscious of the conditions which make them possible, and to defend these conditions even if they should block the path to the achievement of competing ideals." Thus, we need to recognize the material costs that are involved in achieving and maintaining a free society.

Freedom and the free enterprise system have come under attack in recent years as public concern has shifted towards the achievement of a number of other goals, including a variety of social concerns such as ecology and income redistribution. But when these non-economic concerns sap the vitality of the economic system, and ultimately reduce or limit living standards, it becomes time to redress the balance. Our own society has clearly arrived at this point.

In that spirit, let us also focus on the limits of political decision-making. In a political setting, it is appropriate that the majority should decide. Yet, that is hardly the way to meet the great variety of consumer desires. Following universally the approach embodied in voting and the political process can cause needless losses in economic welfare. Let me illustrate that point.

When the original Henry Ford declared that automobile buyers could choose any color so long as it was black, prospective purchasers with different preferenes had recourse to the products of other companies. But if instead the same Henry Ford had been Secretary of a nationalized Department of Automotive Production, the minority desires would have remained unfulfilled.

In our daily lives, there is rarely a need for unanimity of choice. This is where the market system automatically meets individual wants far more effectively than the best-intentioned political process. Returning to the example of the automobile, if 1% of the population desire a car painted in blushing pink, the market can meet their demand--provided they are willing to pay the cost. There is no need to impose a single dominant viewpoint on all automobile purchasers.

In many cases where government does intervene in our daily lives, there may be no need for a standardized response by a federal agency having jurisdiction over the entire nation. Americans in different regions have different needs and priorities, and a decentralized public sector--which is a fundamental characteristic of our federal form of government--can respond to those citizen desires far more effectively.

Public Policy Changes

It is heartening to see the heightened public awareness of the tremendous ability of a private enterprise economy to meet the needs and desires of its citizens. This improved understanding is evidenced by and indeed it has been embodied in several basic changes in the American economy in recent years.

The pace of new regulation of business has slowed down measurably, as our warnings about the high cost of regulation have been taken seriously. Federal civilian spending has been cut back significantly, as concerns about containing the growth of public sector have been heeded. Labor-management relations are sounding a more constructive note; the number of strides is at an all-time low; many collective bargaining agreements have become more realistic, as workers and management alike respond to new economic realities.

Yet it is too soon to say how complete or how durable these changes will turn out to be. Some counterpressures are already visible, notably in the area of environmental regulation, where emotionalism still dominates the public debates. On reflection, I have just employed the kind of euphemism that I criticized others for just a few minutes earlier.

The term "emotionalism" is too kind to describe some of the assaults on sanity that have occurred in recent months in the name of ecology. I have in mind, for example, the wanton and deliberate mutilation of trees in the national forests by "highminded" ecologists who rather see this valuable natural resource destroyed than used by commercial loggers to meet consumer needs. Let us label such dreadful actions for what they are: the totalitarian mind at work, attempting to impose its will on all regardless of the consequences and the desires of others.

Looking out toward the next decade, it is clear that many of the same issues that we have faced over the last 10 years will still be with us. Clearly, this is no time to rest on our laurels. We need only look at the current federal budget and congressional action on tax reform to see that the key problems we addressed a decade or two ago are yet unsolved. We still need to continue urging tax reformers to pay adequate attention to the effects of their plans on saving and investment. We still need to urge major cuts in government spending in order to get the deficit down and to expand the private portion of our national economy. And we must continue to call public attention to the fact that federal credit programs are no free lunch, and that the costs of regulation may be hidden by government but that they are ultimately borne by the consumer.

The development of sound economic theory is important and should be encouraged. But it is not enough. We must be relevant. It is essential that we relate sound economic principles to the important issues of the day. What I am describing is a challenge to economic education that goes beyond classrooms and scholarly journals. Truly, our "classrooms" must be forums that command the attention of large numbers of our fellow citizens. The key "journals" in which we publish the results of our research and analysis must include the national media.

Conclusion

We have much to do. We must realize that our concern for the free enterprise system is part of a larger national debate over fundamental values, and especially over the balance between the power of government and the freedom of the individual. Simultaneously, we must relate economic concerns to the broader interests of the public.

Capitalism has its faults. We should be honest enough to admit them and eager to correct them where we can--that is, where the well-intentioned attempts at improvement will not do more harm than good. We also need to be mindful of the fact that economic institutions, such as the business firm, are not multipurpose organizations. In the productive specialization of labor characteristic of a market economy the profit-seeking corporation is best suited to the production and distribution of goods and services to meet consumer needs.

Attempting to impose on the economic process a variety of seemingly high-minded social obligations erodes the ability of business to perform its true social function. That basic social function of business cannot be underestimated. It is providing consumers a rising degree of economic welfare. To restate the obvious (which often needs to be done), it is the private enterprise system that makes available food, clothing, shelter, and other necessities as well as luxuries of life. That basic social function of business also means creating the economic base upon which a society can meet its important non-economic needs, which range from ensuring the national security to caring for the sick and the disabled.

Finally, we should remind our fellow citizens of the importance of maintaining a society containing a great variety of diverse, independent, voluntary institutions--in both economic and non-economic spheres of activity. Seen in that light, the concern with the future of our economic system is a reflection of our more basic desire to maintain and strengthen the free and voluntary society of which the economy is a vital but only a constituent part. Political freedom requires economic freedom. We foster one as we pursue the other.

If you desire some corroboration of that last point, just take a globe of our planet and spin it. By and large, you will find that the nations with a large and strong private sector are the countries with relatively free political institutions. In striking contrast, those nations where the state dominates the economy tend to be the totalitarian societies. That is hardly coincidence.

Let me conclude with one last point that I feel very strongly about. Any one generation in our country is but a small link in a long chain of time that reaches back to the founding of the Republic and hopefully extends out to the indefinite future. Clearly, there are sharp limits to the good that any one generation can accomplish. But there is an overwhelming duty to ensure that our link does not break--that we carry out our responsibility for maintaining our free society and transmit it to the future.

MARXISM AND THE FREE, CAPITALIST SOCIETY

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INTRODUCTION

As Jean Paul Sartre, the major 20th century representative of Existentialism noted, Marxism is the going idea in our era. Almost every attack on capitalism, or even Western liberalism (as a somewhat ambiguous contemporary stance), draws on the vocabulary of Marxism. Even defenses of the welfare state require Marxian notions about exploitation, property, human nature, alienation, exchange, participatory democracy, planning, labor, and so forth. When capitalism is charged with being wasteful, cruel, reactionary, unjust, dehumanizing, or crass--the charges reek of Marxian underpinnings.

If capitalism means to be a significant intellectual-political alternative in our time, it must confront the Marxian system head on. Yet among capitalist thinkers very few today are concerned with Marx. In the past it was somewhat different. Some members of the Austrian School of economics--notably Bohm-Bawerk and von Mises--have addressed Marx's economics. Hayek, too, has dealt with certain central aspirations of socialists. In a roundabout way, but focused mainly on economic matters, Marxism had to be contended with by those who found capitalism a promising socio-economic system. Yet outside of Thomas Sowell's Marxism: Philosophy and Economics (Morrow, 1985), a recent book on Marxism, and P. C. Roberts's and M. Stephenson's Marx's Theory of Exchange, Alienation and Crisis (Hoover, 1979), few capitalist criticisms of Marxism exist.

THE PARADOX OF LIMITATIONS

There is one interesting explanation for current lack of concern with Marxism. This is that capitalist theorists have a narrow focus.

Capitalists are committed to allowing only a minimal portion of life to be tied to politics. They want to stress only one political point, namely, "Don't tread on me!" or "My life is off limits unless I say otherwise." Expressed a bit curtly, that is the central capitalist ideal. But this leaves capitalists philosophically united on very little. Which is their strength and weakness. Capitalists know that vis-a-vis strangers the only thing one must always keep in mind is a negative duty or a prohibition. They need only remember and respect the rights of others--murder, assault, and theft, and all the variations of these in their complex legal renditions associated with a rapidly developing technological era, may not be committed. And so long as others do the same, capitalists will be theoretically satisfied.

Yet life involves far more than politics. There is family, the arts, sciences, entertainment, sports, hobbies, friendship, and all the variations of these, plus a lot more we think up as we carry on with living. There are problems, challenges, puzzles, mysteries, etc., connected with all of these realms. And there are millions of different ways to tackle them, depending on who faces them and under what circumstances.

None of this falls withing the preview of the politics of capitalism! Which is wonderful as well as scary. It is wonderful because capitalists can refuse to be pretentious. They can remain modest, just as their political outlook requires of them, and they can remain true to their political ideals when they keep all this clearly in mind. It is scary, also, because as capitalists they will probably confront Marxism and other systems of thought in a wide variety of ways, thus making themselves vulnerable to the charge of being confused and divided on crucial issues.

Marxism: Totalitarian in Spirit

Marxism knows it all. You can see it even if you are just watching from the sidelines. Marxists know it all about women's problems, workers' problems, education, drugs, divorce, poverty, technology, psychology, racial conflict, history and all. Marxism strives to be a total system of thought and action. It is also totalitarian, politicizing everything from the nurturing of one's psyche to the building of one's dwellings, all the way to how to plan an economic community.

Marxism is not just geopolitically expansionist, something even some capitalists wish to deny. But as Shirley Christian wrote in The Atlantic: Internationalism--the assistance of fellow revolutionaries--is a key element of the faith to Marxist-Leninists, and telling them not to practice it is like telling priests not to pray. (August 1983, p. 20.) Some will protest: "But that is Marxist-Leninism, not Marxism!" Yet Marx himself said pretty much the same in one of his last letters, to some Russian revolutionaries:

> If the Russian Revolution becomes the signal for a proletarian revolution in the West, so that both complement each other, the present Russian common ownership of land may serve as the starting-point for a communist development. (Karl Marx, Selected Writings, Oxford UP, 1977, ed., D. McLennan)

In short, it's OK to start it in Russia, but it is vital that the revolution be exported! Since Marx also noted that each productive phase of humanity must be fully realized, so it would be impossible to move to communism from socialism without incorporating the attainments of capitalism, even if only by colonizing (near-)capitalist societies.

My concern is not just with geopolitical expansionism. I am interested in the propensity of Marxists to take hold of every issue, ignore completely the ideal of specialization and make every subject their possession, however artificial their treatment of it ultimately proves to be.

First, this is all quite natural within Marxism. Marx thought of humanity as an "organic whole" or, to use another translation of the same phrase, "organic body". And just as wholistic medicine would not permit the separate treatment of various portions of an individual's body, so Marxism will not tolerate looking at sociology or economics or history or psychology or political science as if these could be mastered independently of mastering all the others.

The mastery tends, ultimately, to be prejudicial. It is based on some key formula--in this case the dialetic principle--some notion which has very little to do with the facts at hand. Yet it does appear to be a formidable approach, one that can impress most of those who are eager to grasp things intellectually. The philosopher's stone has been the hope of the ambitious intellectuals who wanted to skip dealing with reality's multifaceted nature and consequent irreducibility of the principles which govern its various domains.

Confronting the Red Balloon

In the end there really is a good deal of hot air in the Marxist edifice. But it is difficult to tell. And there is just enough there that serves some vital intellectual needs, so that unless one's attack of the system is well grounded, one will be gobbled up by it.

For one thing, it isn't enough to retort to Marxism that it is economically naive. Marxism does not pretend to be an economic theory. At the least Marxism proposes a political economy, with emphasis on the "political." Then, also, Marxism has solid rebuttals to those who believe that economics can be a pure, value-free science. Marxists can note that economics studies trade or exchange. And trade or exchange presuppose that some things are owned. But ownership is not a value-free concept since it means: "None but X (or Y or Z) may decide what is to be done with the owned item." If this were not presupposed in market analysis, why would it be assumed that without mutually satisfactory terms, no exchange will ensue? If the valued item is not really owned, why worry about failure to come to terms? It can simply be acquired without mutually satisfactory terms. But "that would be wrong," to quote Richard Nixon.

And in other areas, too, Marx can shake things up with impressive ideas. Economic individualism assumes that persons pursue self-interest. But it has a rather barren idea of what the self amounts to, and Marx has nailed it for that good and hard (in his "On the Jewish Question", in Selected Writings, pp. 53ff). And the list could go on.

What I am trying to get across is that however inadequate it ultimately is, Marxism provides interesting and impressive ammunition against the classical liberal conception of capitalism. And since capitalists agree on very little besides their ideal of negative liberty (which itself is a bit hallow, since it does not provide a clear standard for distinguishing liberty from its infringement, unless one buys into a system of natural individual rights or some other doctrine), many of them find themselves barred from answering Marx.

Going on the Offensive

But there is a way to take the bull by the horns. It is to realize that one isn't just a citizen or political animal but a complete human being. And that means that one needs a way of thinking about life which will have something to place in the path before the Marxian Pacman.

Now I myself think that one requires a philosophic system to do this and I think there is such a system available to us whose various tenets will successfully rebuff Marxism. I'll apply this philosophical framework to crucial Marxist ideas:

1. Marx thinks the world develops dialetically, in a three-fold process, toward its perfection in the end. That is why Marx prophesizes Communism as the last stage of humanity's predictable development--the natural maturation of the organism, as it were. But even if the dialetic method could be found here and there, it is quite evidently not all pervasive. In other words, there is not only one principle of growth or development in nature, even in that part of it which is humanity.

2. Marx accepts the collectivist idea that humanity is the being that one should think of as the individual which may be harmed

or benefitted. He has said plainly enough that "The human essence is the true collectivity of man." He adds that "isolation from this essence is out of all proportion more universal, insupportable, terrifying, and full of contradictions than isolation from the political collectivity . . . " (ibid., p. 126) This means that the most advanced form of human society not only gathers individuals into a political unity--e.g., by way of equal principles of justice or rights--but gathers them into a cohesive cultural body, a "true collectivity". In short, one is the happiest when one is but a cell within the organic body of humanity.

Now this is absurd on its face. If really everyone were a member of our family unit, we would be emotionally crippled all the time. All the deaths, births, anniversaries, illnesses, weddings, joys and sorrows of all persons would have to be as meaningful to each of us as are these matters now when involving our intimates. But intimacy is based on individuality and special relations. Collectivity would demand of us to die emotionally so as to be able to survive all of what happens to everyone in the world. If we really tried to live as if humanity were a large family, we could not do it. Just imagine it--the idea is flat out absurd. Yet that is exactly what Marx demands of the communist person--he and she must regard everyone in humankind as an intimate!

Marx takes this notion quite seriously. All its troubles seem not to concern him. Aside from the above, for example, the human essence involves, first and foremost, persons having goals, determining purposes, making decisions, choosing values, and so forth. These are just what only individual persons, not groups of them can do--even biologically to think otherwise is absurd.

There is more. Marx carries to the ridiculous a dreamy conception we find in much of philosophy, East and West, namely, the view that humankind is all one, that we form not just a large species with much to benefit from interaction but that there really are no selves and what humankind is just comes to one gigantic being. (Another version of this view is that the universe is just one large being of which we are a part, perhaps the conscious part!) We can put it differently. Marx, following such other thinkers as Plato, accepts the idea that the term "human being" is a name for one entity, that the universal concept by which we mean each separate one of us really means just one transcedent being. The universal concept had become a real, concrete entity for Marx. It is as if one would argue that the concept "chair" really stands not for millions of individual chairs but for one large one comprising the rest. For Plato this idea may have served as a kind of myth. It was to remind us of the fact that members of the same species really are members of a species, not disperate, totally separate, isolated entities. As we saw, Marx, too, was reacting to a different extremism which had maintained that we are all independent, isolated atoms. Marx went to the opposite extreme and condemned our individuality to total insignificance. He looked upon humankind as a materially real entity of its own, undergoing its individual development. All the collectivist talk about species-being, liberation, human (not individual) emancipation and the like testifies plainly enough to Marx's view that all persons are really part of this large person, having no brain, no eyes, no memory, no imagination, no regrets, sorrows, joys or delights. Humanity has no consciousness. So what Marx took to be the most important aspect of humankind is really not human at all but some imaginary glob of being, even by his own account of it. If I may venture a suggestion, for Marx humanity will have grown up when it has reached the dumb state of an ant colony or beehive--carrying on without purpose or thought, just automatically. Marx quite explicitly denied that we are human beings. He revered a state of untroubled bliss.

3. From the above, basically metaphysical troubles, there flow numerous other flaws. If humanity cannot really be the depository of human nature, what is? Well, it is our human individuality. This is a bit different from what we get in the individualism of classical liberalism, but some elements of that courageous tradition remain. What the classical liberals got wrong is that each of us is only individual in that we

each count for one being among many others--somewhat as a chair in an auditorium is an individual chair among many others. Rather we are that and more, namely beings who create much of what is crucial about them quite on their own. They are separate not just physically, materially, but morally. They possess individual responsibility for becoming what they will be. That is a major addition to the individualist tradition, one made by Ayn Rand and also, more recently, by David L. Norton (in Personal Destinies, A Philosophy of Ethical Individualism, Princeton UP, 1976).

What this comes to is crucial. Individuals are vitally important to humanity, indeed the most important aspect of humanity. And since individuality is diverse, both because of circumstance and because of personal variations in effort and capacity (e.g., talent), a society must honor individuality first and foremost, in order to be humanly appropriate, good, fit or excellent.

For Marx the exchange economy is a temporary phase of humanity's growth--a kind of adolescence of mankind. It is wild, crude, reckless, but it helps build the organism into a powerful machine. Capitalism, Marx held, was the most productive system of human organization. It is also indispensible--that is why the Soviet Union must conquer us and must have an internationalist expansionist foreign policy, because without capitalism at home and abroad, it hasn't any capacity for survival, let alone flourishing, in Marx's own theory. It is as if a person skipped adolescence and failed to gain all the muscles. He or she would have to remedy matters by taking these from elsewhere or by becoming dependent on those who possess them.

But now, with the individual person back in the center of the important things in human life, what about capitalism? It turns out to be the best system because it can best--though not always, and certainly not necessarily--accommodate any individual's highest rational aspirations.

5. There is a lot more. Marx's conception of science and his attempt to forge a theory of value that conforms to it; his class analysis; his conception of human beings as for the time being passive, etc., etc. All this must be given up once it is understood that individuals, not collectives, are the essence of humanity. And in the wake of this realization, the capitalist market is vindicated. The vindication is, moreover, a moral and scientific one.

KNOWLEDGE, ETHICS AND THE CASE FOR A FREE MARKET IN EDUCATION

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"A general State education is a mere contrivance for moulding people to be exactly like one another; and as the mould in which it casts them is that which pleases the predominant power in the government - whether this be a monarch, a priesthood, an aristocracy, or the majority of the existing generation - in proportion as it is efficient and successful, it establishes a despotism over the mind, leading by natural tendency to one over the body." (John Stuart Mill, On Liberty, Pelican Classic, 1981, p. 177)

In its classical form, the case for the market as the primary institution for the allocation of resources is an argument which appeals to the value of efficiency. Our circumstance as human beings is that of creatures which find themselves in a world of scarcity. We confront scarcity in the necessities of life and in all goods that make life civilised and gracious. In addition, we find that there is among us a marked diversity in desires and preferences. We differ deeply, not only in our preferences about consumption and the investment needed to build up a store of goods for future consumption, but also in how we rank goods against each other. There is, for these reasons, a competition for resources between us that mirrors the choice each of us must make between the scarce resources he has at his disposal. The function of the market, in this classical account, is that of an *economizer* on scarce resources. Market institutions allow different intensities of preference for goods to be reflected in prices, which in turn themselves permit the rational allocation of resources to economic agents willing and able to pay those prices. From the standpoint of the avoidance of waste and the generation of wealth, no other institution allocates resources as well as the market does. The market is to be defined, then, on this classical view, because it allocates resources efficiently, in accordance with the revealed preferences of economic agents--and because it does so without the waste, inconvenience and dangers to liberty associated with mercantilism and central planning.

This is the case for the market we find in the great classical economists, above all in the writings of the Scottish political economists, and in their neoclassical successors. It is an argument of considerable force. Nevertheless, it has weaknesses. The picture of market institutions as devices for allocating scarce resources to known ends tend to entrench the *communistic fiction*--the fallacy that society can be theorized as a household, in which an agreed hierarchy of values exists. The real social world contains no such consensus on values. As we know it among ourselves, society encompasses different moral traditions and different consequent conceptions of the good life. Still more fundamentally, no one can really know in any concrete or determinate fashion what is the structure of others' preferences. We are changeable creatures, revising and altering our preferences in accordance with experience and opportunity. We do not, and cannot in the larger society, know each other as the members of a family know each other.

It is on this basis that a rival paradigm of market institutions is advanced by the economists of the Austrian School. For these economists--most especially, for L. van Mises and F. A. Hayek--the market is the solution to *a problem of knowledge*. This problem is that the knowledge existing in society is dispersed throughout it and is available to no one person or group of persons. Nor can this knowledge be collected by any central agency and then used for purposes of central economic planning. It cannot be so collected because, in the first place, it is largely knowledge of fleeting and local circumstances. Even if, at vast cost, such knowledge could be collected, it would be dated and useless long before it became available to the central planner. This is to say that, in virtue of the fact that the world we live in is kaleidic and in constant flux, little knowledge can be usefully centralised and then used for planning purposes. There are other, more profound reasons why the knowledge dispersed throughout society cannot be centralised in a planning authority. This knowledge, as well as being often knowledge of local circumstances, is primordially *practical* knowledge. It is stored in habits and traditions embedded in skills and dispositions, buried and submerged in conventions and practices of various sorts. The knowledge we have of ourselves and our social environment is, in other words, a species of *tacit* knowledge. It is not articulated in explicit theories, and often it cannot be made explicit. Our explicit or theoretical knowledge is, accordingly, only the visible tip of the massive submerged iceberg of the tacit social knowledge on which we all depend. Finally, much of this knowledge is knowledge of subjective phenomena--of intentions, preferences and values. In the larger society in which we live, the values prized by people do not form a stable hierarchical system, as perhaps sometimes they do in families, but instead are a cosmos in continuous change. It is a feature of central economic planning, however, that it presupposes fixity in preferences and values, when in reality there is flux.

The function of the market, at its most fundamental, is then to discover and transmit throughout society the knowledge dispersed among its members. It does this in a variety of ways. It serves as a *discovery-procedure* for the preferences people already have, in all their changeable varieties. It embodies in the price mechanism the tacit knowledge on which people act, but which they may be incapable of articulating. It permits the coordination of values and conceptions of the good which would not otherwise be commensurable or combinable. And, in all these ways, the market serves as an epistemic machine, generating, transmitting and utilising the dispersed knowledge and information in society in a way that no central planning bureaucracy could rival.

In this Austrian view, the case for the market and against central economic planning is not one that depends on the role of incentives in motivating productive efforts. Nor is it even one that appeals to the economising functions of the market in allocating scarce resources efficiently. Instead it is one that invokes the epistemic properties of the market in promoting the coordination of men's activities.

The Austrian theory of the market incorporates a defense of market institutions that is knowledge-based and whose central idea is that of coordination (and not the idea of efficiency in its standard sense). The Austrian theory yields a critique of central economic planning which is decisive in theory--and amply corroborated by the history of interventionalism in the west and of socialist planning in the Soviet and Chinese blocs. The key point in the Austrian defense of market institutions is that, by decentralising economic decision-making, we accept and submit to the decentralised or dispersed character of knowledge in society. But the Austrian case for the market has a further element. Market institutions allow for the elimination of errors in a way that planning institutions do not. In a free market, errors are sifted and filtered out, almost automatically by the operation of the profit system. This filter mechanism has no analogy in a centrally planned economy, where bureaucrats will often be unable to detect errors and, even where they can identify them, will have an interest in concealing them. The market allows for the fallibility and limitations of our knowledge in ways that planning cannot. It is this insight, along with the others I have sketched, which goes far to account for the overwhelming intellectual victory of Mises and Hayek in their disputes in the 30's and 40's with the socialist economists.

The Austrian argument is that free markets utilise knowledge better than any planning system could conceivably do so. But how does this general case for freedom of enterprise affect the case of education? Let us see.

We will recall that one fundamental reason why the knowledge dispersed in society cannot be centrally collected is that much of it is tacit or practical knowledge that is not articulated in theories or prepositions. Now a crucial element in this fund of tacit knowledge is moral knowledge. In all our dealings with each other we rely on an inheritance which has only very partially been theorized by moral philosophers. We draw on this inheritance in personal and family life, in business and scholarly enterprise, and in our relations with the law and government. It is this inheritance that is passed on, from generation to generation, by education and upbringing.

Much, and perhaps the greater part, of this process of cultural transmission goes on outside formal institutions of schooling. It occurs in the family, the church, the neighbourhood and peer group. The part that occurs in the schoolroom is nevertheless crucial. It is vital to the development of the young into responsible moral agents and, thereby, to the preservation of a society in which persons accept responsibility for their voluntary actions. It is here that the superiority of a free market in education over state-controlled education is most clearly shown. Like any other kind of tacit knowledge, moral knowledge is dispersed throughout society. It is embodied in persons and expressed in their conduct. In societies as diverse as those of the modern Western nations, the tacit moral knowledge possessed by their members exhibits a degree of variety and subtlety which far exceeds the tacit knowledge they possess of their economic circumstances. In other, more familiar terms, this is to say that our societies contain a spread of moral traditions and forms of life which differ greatly among themselves. They may have some common features, but the divergences among them are just as important. Our societies are culturally, ethnically and religiously pluralistic. Properly conceived, the role of the educational institutions is to foster and express this pluralism, so to enable society to make best use of the varied moral beliefs and practices which society contains.

Traditions and forms of moral life may be conceived as "experiments of living" (in J. S. Mill's celebrated phrase). We are all the poorer if any way of life that exists among us is stifled by government intervention or repression. We can learn from the Amish, just as there may, perhaps, be something to be learnt from schools using the Montessori method. Toleration of diversity cannot, to be sure, be boundless: there cannot be toleration of groups or practices which involve violations of rights or assaults on the framework of the free society itself. Within these limitations, we all benefit by allowing different ways of life to make a trial of their beliefs, each in its own terms.

Like central economic planning, governmental control of schooling has an inexorable tendency to deplete and impoverish the common stock of knowledge in society. Government bureaucrats are ill-equipped to know the preferences of families or the specific needs of children. Even where these are known, government has no clear interest in respecting them. Indeed, governmental educational institutions are peculiarly vulnerable to capture by activist idealogical minorities. When this occurs, as has happened already in many parts of the Western world, the moral variety of the free society is subjected to an attempt at ideological standardisation. Homogeneity and uniformity replace the natural diversity of free persons. In the process, the goals and values of individuals and families are thwarted in the interests of a governmental policy which treats them as resources for policies of social engineering rather than as autonomous bearers of knowledge and values.

No less than central economic planning, government control of education is bound to fail to attain its objectives. Because it cannot utilise the dispersed moral knowledge of the community, it will be clumsy, wasteful and often counter-productive in its policies. Once again, history supports theory. In most Western nations, the last half century of governmental control of education has witnessed declining standards of literacy and culture, with excellence surviving chiefly in the private sector. On the other hand, the explosive growth of literacy in the nineteenth century occurred in England and America before, and thereafter in considerable measure independently of, state involvement in education. The lesson is clear that government involvement in education is exposed to all the hazards which beset government involvement in other areas of social life.

There is a special risk attaching to government intervention in education, however, which is probably far more serious than that attending other kinds of intervention. Education is the means whereby society replaces its moral capital. It is extremely difficult for a society to rebuild its moral capital, once it has been substantially depleted. The impact of governmental control of schooling, at least over the last few decades has been to bring about a dwindling of our inherited moral capital. It is not hard to see how this reckless consumption of moral capital will affect the economic prosperity of society, and ultimately, perhaps, its prospects of survival?

The policy implications of these insights are clear enough. They embrace the wholesale privatisation of the schooling system and its return from national or local political authorities to the control of families and voluntary agencies. We need not deny that government may have some role in education, by way of the structure of taxation or even the introduction of a voucher scheme. Everything suggests, however, that if governmental control of education ever had utility, then that utility is now gone. By way of a subtle argument about the uses of tacit knowledge in economic life, we have come to see that the preservation and growth of our fund of moral knowledge depends on a massive withdrawal of government from education. It remains to be seen whether this insight can be translated into the terms of practical political discourse.

BETWEEN STERILITY AND DOGMATISM: THE MORALITY OF THE MARKET AND THE TASK OF THE ECONOMICS TEACHER

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This paper will try to describe an approach to the teaching of economics that might improve our chances of avoiding both sterility and dogmatism.[1]

In the course of arguing for the approach, I want to present and defend the heretical claim that economics has a great deal to say about the morality of the market.

Scylla and Charybdis

The sterility with which I am concerned comes from refusing to draw a conclusion until we think we have provided a complete statement of the conditions that must be met for the conclusion to follow rigorously. Economists who behave in this antiseptic fashion give the impression to students that their discipline has nothing of real importance to say about social issues. The opposite danger is dogmatism, which appears when we present conclusions without adequate supporting evidence and argumentation--without just what it takes to produce sterility.

If this account is roughly correct, there may be no channel through which to steer between the rock of dogmatism and the whirlpool of sterility. In that case we would be in urgent need of an alternative route. Sterility and dogmatism, in case they don't stand self condemned, are serious impediments to the generation and maintenance of student interest. Interest is essential to learning, because people learn nothing in which they have not first become interested. Threats such as low grades can sometimes stir interest--they induced me to learn the multiplication tables. But threats are far less effective and reliable in nurturing interest than is the belief that valuable insight or understanding lies ahead.

The core of my recommendation is simply that economics be taught with far more attention to social *processes*. We spend too much time, I believe, on the formal relationships among static variables. We neglect the more interesting and significant issues: What processes created and now maintain these relationships? What subsequent processes can we anticipate as a result of these relationships or the introduction of new factors?

Formal Analysis

Suppose you're teaching the orthodox "theory of the firm" (or what we oddly call "the theory of the firm" even when the actors are not firms but net-revenue-maximizing black boxes). You show your students when and why marginal revenue lies below demand for a particular seller, and what will happen when marginal revenue and marginal cost are less than price. You derive and display the familiar triangle between the demand curve and the marginal cost curve that results from the seller's decision to restrict sales to the quantity at which marginal revenue equals marginal cost. What do you do next?

What can be extracted from this set of formal relationships among static variables: demand, price, marginal cost, marginal revenue, quantity? Can we demonstrate waste, inefficiency, non-optimality?

Many of us try. We go through contortions that numb the minds of our students in a largely vain effort to derive some significant conclusion from the analysis without violating our canons of scientific procedure. We would like to demonstrate--rigorously, of course--that an expansion of output to reduce the size of the triangle is a Pareto-superior move. But we need to make some assumptions in order to get to this conclusion, assumptions that are very hard even to state clearly. Zero transaction costs is a favorite. What is there about zero transaction costs or perfect information that makes economists think it will justify policy conclusions? Why don't we allow zero transportation costs to perform a similar function in our analysis? One can defend any policy conclusion at all if allowed to abstract from everything that would defeat the policy. I believe I could "solve" all the social problems of the world if allowed to assume zero transaction costs. Is it not the case that distinctively *social* problems are always the result of positive transaction costs, and would disappear if transaction costs were zero?[2] What in the world are we doing when we introduce such assumptions in order to draw conclusions? The truth of transaction costs is that they exist, in a multitude of surprising and unexpected forms. They are part of the processes of social interaction. There are all sorts of very real and important costs associated with social transactions that we had tended to overlook before Ronald Coase, or Frank Knight before him, taught us to see why the social world so often fails to meet our expectations.[3]

Substantive Analysis

The beginning of substantive as distinct from purely formal economic analysis is dissatisfaction. We begin by observing an unsatisfactory state of affairs, or what we suspect to be an unsatisfactory state of affairs, or what someone else says is an unsatisfactory state of affairs. Our formal analysis, with cost curves and demand curves, is a preliminary exercise, an aid to thinking that acquires meaning only when it is put to work on some real, or at least recognizable, social transactions: the marketing of airline tickets, for example, or of restaurant meals, prescription drugs, hard-cover and paper-cover books, new textbooks and used textbooks, bachelors degrees, foreign automobiles, crude petroleum, long distance telephone service, or any other price-cost relationship troubling enough to prompt the question: Is this what we want?

Our tools are put to interesting and important uses when we employ them to construct plausible accounts of social processes in response to some kind of dissatisfaction with an observed state of affairs. These accounts can look backward or forward in time. We can try to explain how the observed situation came about; or we can try to predict what will happen if some new factor is introduced, such as a change in the law. This, I submit, is the knowledge we're after whenever we are trying to evaluate a situation.

Criticism and Inquiry

Suppose, for example, that a student complains about the difference between what the bookstore pays when it buys back used books and what it charges when it resells them. Does the student have a legitimate complaint? We are regularly told that economic analysis cannot answer such questions; but that is a half-truth at best. If economic analysis cannot tell us what *ought to be*, it can often tell us a good bit of how matters might have *come to be*. What is the social process through which the gap between buying price and selling price is established and maintained? That is basically what we must know in order to judge whether or not the bookstore is behaving in an unfair or otherwise unacceptable way. And that is precisely the sort of knowledge economics can help us acquire. It is true that no finite account of the process can be guaranteed in advance to settle the question of fairness to any particular person's satisfaction. But that implies no more than any inquiry might have to be extended. In what direction? In whatever direction the continuing questions of the dissatisfied inquirer may point us.

A situation cannot be judged satisfactory or unsatisfactory, of course, until it has been compared with alternatives. Economics provides the same kind of assistance here. If our indignant student judges the bookstore's used-textbook practices unacceptable, the question of an alternative system immediately arises. "What changes would he recommend?" When the recommendation for reform is presented, economic analysis can attempt to anticipate its consequences. Once again the consequences will be a *process*, and not simply a clearly-defined state of affairs at some future date. The proposed reform can then be evaluated in the light of the flow of consequences anticipated from its introduction. There is again no guarantee that the asserted consequences will convince any particular person that the proposed reform is either desirable or unacceptable. Anyone may want to push the inquiry further. While refusing to decide is in practice itself a decision, in principle economic analysis can continue indefinitely.

Positive-Normative or Simple-Complex?

The claim that economic analysis can never settle normative questions is demonstrably false, since it often does exactly that. It is quite true that economic analysis *by itself* can never settle normative questions, but economic analysis never exists "by itself." The knowledge anyone acquires through economic analysis always exists in conjunction with a lot of other knowledge, beliefs, values, assumptions, working principles, and matters taken for granted. Economic analysis presents arguments, and no argument, not even the most respectably rigorous one, will necessarily convince anyone, much less everyone. That's just as true, however, of so-called positive economics as it is of normative economics.[4]

Certain kinds of questions are indeed easier to answer than others. Clearly-formulated questions, simple questions, and questions resting upon a broad or deep consensus are easier to answer than carelessly-formulated questions, complex questions, or questions that beg questions. The gulf that so many economists believe they see between positive and normative questions reflects, I think, a misinterpretation. The questions we call "positive" are the ones on which we think we know how to achieve agreement: the clear, simple questions that arise within a well-understood and accepted framework of thought. We label a question "normative" not because it is categorically different from "positive" questions but because we don't (yet) know exactly how to go about agreeing upon an acceptable answer.

More Misleading Distinctions

Perhaps economists pay so little attention to processes and so much attention to static outcomes at well-defined points in time and space because we find it so much harder to pose questions we can answer definitively when we inquire about processes. That is probably also why we disavow any knowledge of equity but claim expertise on efficiency. We may know less about efficiency than we suppose, however, and more than we realize about equity. Every measure of efficiency is a ratio of values; there is no such thing as technological or objective efficiency. It follows that every measure of efficiency presupposes the appropriateness of particular evaluations, which means, to make a long story short, that every measure of efficiency presupposes the acceptability of some set of entitlements or property rights. Who has the right to value, or to have their valuations counted? An authoritative statement about efficiency rests upon an implicit judgment about equity.

The means-ends distinction is another device we commonly use to confine the questions we ask within manageable bounds. That dichotomy, too, tends to steer us away from the study of social processes into the examination of static conditions: the formal conditions entailing the most effective allocation of given means for the achievement of given ends. In reality, however, neither means nor ends are ever given. We have no ends, but only provisional goals which are going to be means toward the achievement of further goals if we reach them; and those further goals will also be provisional and also really means. We don't know what we're after, even though we are highly purposive creatures. We largely find out what we want in the process of trying to get it. And one thing we want is to discover more about the means at our disposal. Our goals change as we approach them. There are no "final goods," no benefits at the end to be totted up and compared with all the costs in some grand benefit-cost analysis, because benefits often turn into costs and costs into benefits before we get to the end--except that there is no end, unless it's death, whereupon it's too late for benefit-cost analysis to serve any purpose. The means-ends dichotomy is a useful simplification. When invoked as a dogma, however, it distorts our perceptions and obscures the important truth that purposive behavior, especially among a society of cooperating persons, is a process and not a problem in pure logic.[5]

I do not want to be misunderstood. I am prescribing, not proscribing. Economists should and will continue to engage in static analysis, because it stimulates their interest, advances their careers, and also sharpens the tools we use to analyze social processes. My concern is that the prestige and satisfactions of static analysis not deter economists, especially teachers of economic principles, from also using their tools to construct plausible accounts of social processes in response to problematic situations.

Moral Judgements and Social Processes

I want to conclude with the altogether heretical argument that we are seriously underestimating the power of our analytical tool kit and the relevance of our discipline to public policy when we contend that economics has nothing to say about justice or other ethical issues. By making this self-denying claim, we surrender the right to discuss the morality of the market to those who don't understand how markets work. If economics is practiced exclusively in the formal-static mode, it will indeed have little to say about justice, because justice in large societies characterized by market interactions is far more a matter of process than of outcomes or states. Whether a situation is or is not unjust will depend on the processes that produced it. There is no such thing as an unjust *pattern* of income distribution; or, if there is, I have yet to encounter a clear and coherent explanation of how it could be recognized. There are, however, unjust *actions* that distribute income in particular ways. When economists discuss the social processes through which income is allocated, they are, whether they wish to or not, illuminating the morality of those processes.

It is not the outcome but the process itself that enables us to approve or condemn the functioning of the market in particular cases. Outcomes such as poverty, unemployment, or inequality are only relevant as clues or guides to inquiry. I am not merely arguing that this is how we *ought* to assess the morality of the market; I am contending that this is *in fact* how we do it, even when we describe what we are doing quite differently. I am thus making an empirical claim, a claim that can be tested by examining the processes of moral reflection and moral discourse in which we regularly engage. Someone who asserts, for example, that great wealth amid grinding poverty is an unjust *state* is, I believe, putting forward the hypothesis that any such combinations that we observe will be found to have emerged from unjust processes.

To be Continued

But what constitutes an unjust process? While that isn't an easy question to answer, neither is it the altogether empty question that so many economists seem to suppose. What processes do we in fact condemn as unjust? What do our actual processes of moral reflection and moral discourse reveal? There is no ultimate answer, of course. There never is, at least not to any human question. Those who practice economics as a humane science, rather than a branch of human engineering, must learn how to be content with less than ultimate answers and with suggestions that are merely plausible.

NOTES

1. The approach is hardly novel. F. A. Hayek is its most eminent contemporary practitioner, but Adam Smith was working this way in the 18th century. I presented an earlier version of these recommendations in March, 1986 to students and faculty at Whitman College in Walla Walla, Washington. They might not even recognize the present version, but their questions and comments made a significant contribution to my reformulation of the argument.

2. If all members of every society had "perfect information," including correct information about what everyone else wanted and how much each would sacrifice to obtain (or avoid losing) what was valued, what kind of *social* problems could possibly arise? There would be no wars, for example, because with the outcome of any conflict known in advance, the parties would simply settle on the terms that conflict would impose. The price system on which economists lavish so much study (properly, in my view) would be unnecessary in a world of perfect information costlessly acquired by all.

3. The classic reference is to R. H. Coase, "The problem of social cost," *Journal of Law and Economics* (October 1960). Knight's discussion of methods for meeting uncertainty was a much earlier exploration of these themes. Frank H. Knight, *Risk, Uncertainty and Profit* (New York: Harper and Row, 1965; originally published in 1921), especially Part III.

4. Donald N. McCloskey has done much to make this position more acceptable, or at least familiar, in the economics profession. See especially McCloskey, "The rhetoric of economics," Journal of Economic Literature (June 1983).

5. No one has argued more cogently for the position taken in the two preceding paragraphs than Frank Knight. See especially the first two essays in Frank H. Knight, The Ethics of Competition and Other Essays (Chicago: University of Chicago Press, 1976). One of Knight's most distinguished students, James Buchanan, maintains that Knight himself failed fully to appreciate the limitations that his own arguments place upon the conception of economic activity as essentially maximizing activity.

INFLUENCES ON ENTREPRENEURSHIP

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What factors bear upon the birth of new growth-oriented firms? How does it happen that particular people start certain businesses at particular times and places? What are the implications for cities or regions attempting to foster economic development through encouraging entrepreneurship?

A number of previous studies have examined the processes leading to the birth of new firms. This paper will summarize the findings from this previous research and consider their implications for regional economic development.

New firms can contribute in a variety of ways to the growth and vitality of an economy:

1. They are important sources of innovation, sometimes achieving great success in matching developing technologies and market needs.

2. They add to the vitality of industry, serving as new sources of competition and complementing and spurring the efforts of established firms.

3. They can generate substantial numbers of jobs. (One American study found that 80% of the new jobs created during the period 1974-76 occurred in firms which were less than five years old).

4. In regard to regional economic development, they diversify the industrial base, creating local headquarters and centers of growth.

Although many new businesses enjoy only modest success and others fail, some are extremely successful. In the United States, firms such as Apple Computer in computers, Federal Express in overnight mail delivery, and Intel in semiconductors all have achieved outstanding success in the relatively short time since their founding. Compared to other kinds of new businesses, high-technology firms have experienced relatively low failure rates. For instance, of 250 high-technology firms founded on the San Francisco Peninsula during the decade of the 1960's, only about one-third had discontinued by 1980. (About one-third had been acquired and one-third were still surviving and independent). The employment generated by new firms, considered in the aggregate, can be substantial. For example, spin-off firms from the major laboratories affiliated with M. I. T. provided, within a few years of founding, substantially more employment than the parent laboratories.

The birth of these new firms seems to be concentrated in particular places and at particular times. In America, cities such as Boston, Los Angeles, San Francisco, Salt Lake City, and Minneapolis have had in recent years large numbers of new firms. There are other regions which, although they employ large numbers of technical personnel, have had relatively few new companies founded. Some of the regions in which the founding of growth-oriented firms has been studied are indicated in Exhibit 1.

These studies vary widely in the specific aspects of entrepreneurship considered. However, taken together, they should help us to understand the influences upon entrepreneurship. The findings have implications both for prospective entrepreneurs and for those concerned with regional economic development.

Exhibit 1

GROWTH-ORIENTED FIRMS STUDIED

Areas	Number of Firms Studied*
Ann Arbor, Michigan	76
Austin, Texas	31
Boston, Massachusetts	250
Bryan/College Station, Texas	32
Buffalo, New York	42
California	197
Canada (nationwide)	40
Canada (nationwide)	47
Erie-Niagara, New York	43
Minneapolis-St. Paul, Minnesota	142
Oak Ridge, Tennessee	21
Palo Alto, California	250
Pittsburg, Pennsylvania	51
Pittsburg, Pennsylvania	16
Salt Lake City, Utah	8
Sweden (nationwide)	49
United Kingdom (nationwide)	192

*These do not represent all new firms founded in the areas indicated, only those studied.

Influences Upon Entrepreneurship

The founding of a new firm is, in a basic sense, a decision made by one or several entrepreneurs. The influences upon this decision might be organized under three general headings:

1. The entrepreneur himself, including the many aspects of his background that affect his motivations, his perceptions, and his skills and knowledge.

2. The established organization for which the founder had previously been working, which might be termed an "incubator organization." Its characteristics influence the location and the nature of new firms, as well as the likelihood of spin-offs.

3. Environmental factors, many of them regional in nature. They shape the climate and make it more or less favorable for the founding of new firms.

These influences are summarized in Exhibit 2.

Exhibit 2

INFLUENCES UPON THE ENTREPRENEURIAL DECISION

Antecedent Influences Upon Entrepreneur

1. Family
2. Membership in sub-culture
3. Educational background
4. Psychological makeup
5. Age at time(s) of maximum external opportunity and organizational "push"

Incubator Organization

Entrepreneur's Decision

1. Geographic location
2. Nature of skills and knowledge acquired
3. Motivation to stay with or lease organization
4. Experience in "small business" setting
5. Opportunity to form entrepreneurial groups

Environmental Factors

1. Examples of entrepreneurial action and availability of knowledge about entrepreneurship
2. Societal attitudes toward entrepreneurship
3. Ability to save "seed capital"
4. Accessibility and availability of venture capital
5. Availability of personnel and supporting services; accessibility to customers; accessibility to university
6. Programs to assist entrepreneurs

The Individual Entrepreneur

What are the characteristics of those people who choose to take the unusual step of starting new companies? What prepares and propels them toward this unique activity? Previous research suggests that people who start companies do have some distinctive characteristics. In examining these attributes, we should recognize that there is considerable diversity. For instance, a founder of an automobile repair shop often has a different background and different expectations than the founder of a growth-oriented high-technology enterprise. Our primary interest here is with growth-oriented firms; however, some of the findings reported are from studies examining a broad cross-section of entrepreneurs.

1. Founders seem to be more likely to be from families in which their parents or close relatives were in business for themselves. One large study of 1,805 American small business owners indicated that 50% were from families in which a parent had owned a business, a remarkable high percentage. Presumably, the young person growing up in such a family sees the parents as "role models;" even if the parents are unsuccessful, the act of starting a company seems feasible.

2. Many cultural groups, such as the Chinese in Southeast Asia, Indians in East Africa, or Jews in America have a tradition of members starting businesses. Thus, in studies of high-technology founders, 50% of those in a Canadian study were immigrants and 16% of those in a Boston study were Jewish.

   These patterns may have been fostered because prejudice blocked others ways of getting ahead. Then, children growing up in such groups are surrounded by examples of entrepreneurship and learn what is involved in working in businesses.

3. Although there have been some mixed findings, recent studies in the United States indicated that entrepreneurs have more education than the general population. This is particularly the case for founders of high-technology businesses; in two studies the typical educational background of technical entrepreneurs was an M.S. degree. Since technical firms build their competitive advantages upon the founders' knowledge, strong educational backgrounds are to be expected.

4. People who start companies seem to have certain psychological characteristics. Their scores on "locus-of-control" tests indicate that they believe that they can control their own destinies. They are less likely to think that forces beyond their control will determine their success. Many entrepreneurs also tend to be goal-setters. They gain satisfaction from setting goals which are moderately challenging (but not impossibly difficult) and then achieving those goals. Interestingly, they do not have a greater propensity to take risks than the general population. They see themselves as taking moderate risks in achieving their goals. To an outside observer, the process of starting a firm may seem to involve enormous risks. However, to the entrepreneur, who believes that he or she can make that business successful, the risks seem more moderate.

5. The age of the founder at the time he or she is interested in starting a business is also a factor. People of all ages start businesses, but in the United States about two-thirds are in the age range of 25 to 40. Younger people might have strong desires to start businesses, but often do not have the money or experience needed. Older people may have money and experience, but they also often have obligations to support families and may be reluctant to risk what they have achieved.

All of this suggests that some people are more likely to start new businesses than others. This does not mean that people with other backgrounds cannot or do not found firms. However, certain backgrounds seem to make people more prepared--more likely to take this step if the right opportunity arises. Whether they actually do depends upon other factors which we shall now consider.

Incubator Organizations

When a founder starts a new company, he typically leaves some organization. The characteristics of that organization, which might be termed the "incubator," influence entrepreneurship in a number of ways.

1. The incubator organization affects the location of the new firm. Even though founders may have been geographically mobile at earlier stages of their careers, they rarely move at the time when they are founding new firms. The percentage of new companies started which involved at least one founder who was already working in the area ranged from 97.5% among 250 Palo Alto entrepreneurs to 79% in a study of 890 founders across the United States.
   By starting in the same region, the entrepreneur can utilize first-hand knowledge of markets and suppliers. It may thereby also be possible to start on a part-time basis while maintaining a job. The full energies of the founder also can be focused on the start-up, without the diversions associated with moving a family. One implication is that regional entrepreneurship is largely dependent on the pool of people already living in an area.

2. Established organizations also influence the nature of the new businesses established. This is particularly the case with high technology firms, in which current knowledge of technologies and markets is essential for success. Previous studies have found new businesses closely related to the technology or markets of the incubator organizations for 75% of 890 founders from a cross-section of industries and for 84% of 250 technical entrepreneurs.
   The new firm typically depends upon what the founder knows and can do. That is often related to what the founder learned to do in the incubator organization. One implication is that the nature of new firms started in an area is likely to be related to the nature of organizations already there.

3. The established organization also appears to influence the motivations of the entrepreneur. People who are frustrated because they cannot get along with their boss or because their ideas are turned down or who have lost jobs because of plant closings are ready to consider a change.
   Findings from previous research vary widely (possibly due to differences in research methodology), but it appears that from 20% to 83% of founders studied left their previous jobs because of strong negative "pushes." Furthermore, some organizations which have spun off many entrepreneurs seem to have done so most often during times of internal troubles and change.

4. Spin-off rates appear to vary widely, even among firms in the same industry. One factor which seems to have a bearing is the size of the incubator organization. Four different studies have indicated that small firms tend to have higher spin-off rates than large firms. In England, small firms considered as a class (less than 250 employees) had spin-off rates six times as high as large firms considered as a class. In small companies, employees are learning about technologies or markets which can be exploited by small firms. They also develop broad experience and can see what is involved in managing a small firm. There is also probably some self-selection, with those choosing to work for smaller firms probably being more entrepreneurial.

5. Incubator organizations also provide the setting within which founding teams can be formed. New firms, particularly growth-oriented firms, are often founded by teams of two or more founders. A study of 890 foundings indicated that 40% involved teams; in another study of 955 high-technology foundings 59% involved teams. (Other research has indicated that companies started by teams tend to be more successful.) Teams permit the assembly of a broader range of skills; for instance, a founder strong in manufacturing can work with another founder strong in marketing. Members of founding teams often meet each other in the incubator organization. If the incubator organization includes, at a given site, all of the key functional activities, such as engineering, manufacturing, and marketing, then it is more likely that balanced founding teams can be formed.

Incubator organizations influence not only the nature of new firms, but also whether spin-offs actually occur. Existing organizations, even within the same industry, vary widely in the extent to which their employees leave to start new firms. Exhibit 3 indicates the characteristics of firms and the industries in which they operate which may be associated with high or low birth-rates of new firms.

Exhibit 3

INDUSTRY AND ORGANIZATIONAL ATTRIBUTES RELATED TO THE BIRTH-RATE OF NEW FIRMS

Characteristics of Industry

Low Birth-Rate	High Birth-Rate
slow industry growth	rapid industry growth
homogeneous markets	opportunities to segment markets
heavy capital investment required	low capital investment required
substantial economies of scale	minor economies of scale

Characteristics of Estabished Incubator Organizations

Low Birth-Rate	High Birth-Rate
large number of employees	small number of employees
organized by function	product-decentralized organization
recruit average people	recruit very capable, ambitious people
relatively well-managed	afflicted with periodic crises
located in isolated area of little entrepreneurship	located in area of high entrepreneurship

All of the attributes in a given column are not necessarily found together nor are they required to bring about a given spin-off rate. Various combinations may exist.

What would be the characteristics of an ideal incubator organization? It would be located in a growing industry, characterized by opportunities to segment the market. Capital investment requirements and economy-of-scale effects would be relatively low. It would be a small business or organized as a series of small businesses. It would recruit capable ambitious people and it would periodically be afflicted by internal crises, leading its best employees to conclude that "Even I could manage a business better than this."

Environmental Factors

A complex of factors external to the individual and external to the incubator organization appears to influence entrepreneurship. Research to date provides us with only a limited understanding of the effect of many of these factors. Yet it is clear that they interact to create climates more or less favorable to entrepreneurship. It is also clear that climates can change over time and that, to some extent, past entrepreneurship makes future entrepreneurship more likely.

1. The decision to found a business is affected by the entrepreneur's perceptions of risks and rewards and his knowledge of sources of venture capital and of individuals and institutions which might provide help and advice. Past entrepreneurship creates what might be termed an "entrepreneurial environment," in which the prospective founder is surrounded by examples and enveloped in knowledge about the process. A number of researchers report that the credibility of the act of starting a company appears to depend, in part, upon whether the founder knows of others who have taken this step.

2. Societal attitudes toward business and entrepreneurship are also undoubtedly important in influencing an individual's decision. Studies in a variety of countries show that some cultures are more entrepreneurially inclined than others.

3. Venture capital is supplied both by the founders themselves and by external individuals and institutions. In one American study, 47% of the firms were started primarily with founders' capital; in a Canadian study, 35% of high-technology firms were initially financed by the founders. The extent to which founders can save sufficient capital depends upon salary and taxation levels. Observers believe that entrepreneurship in some countries, such as the United Kingdom, is seriously hampered by the difficulty in saving "seed capital." In the American electronics industry, stock options, which are often intended to bind executives to firms, sometimes make it financially feasible for them to become entrepreneurs.

4. Institutions and individual investors vary substantially in the extent to which they are willing to invest in particular kinds of new, growth-oriented firms. The prospective founder seeking capital must thus try to make contact with the "right" sources of capital, those whose experience and attitudes make it more likely that they will assist this kind of venture. In areas of active entrepreneurship, well-developed communication channels may have developed, such that it is relatively easy for the prospective founder to make contact with promising investors or lenders. Successful past entrepreneurship can create local wealth and also change perceptions of the risks and rewards associated with lending to or investing in new ventures.

   Attitudes toward investing in new, technically-based firms can change substantially over time. The success of Control Data in Minneapolis and Tracor in Austin apparently helped to change the local investment climate and made the raising of capital by subsequent waves of entrepreneurs much easier. Of course, the reverse can happen also. The American "new issue" market virtually collapsed in the early 1960's and again in the mid-1970's, reflecting extreme skepticism about the prospects for growth-oriented firms during those periods.

5. How important are the economics of location, including transportation costs and the development of complexes of related firms which buy from and sell to each other? It does appear that the growth of a complex conveys many benefits to new firms. These include pools of trained labor and the development of specialized suppliers. Although transportation costs may not be very important with many high-technology products, the ability to work closely with customers is sometimes essential. Location in a complex may be particularly important for those new firms which provide custom manufacturing services and which serve as satellite suppliers. An additional benefit is the development of specialized expertise among local accountants, bankers, and lawyers relating to the special needs of small, growth-oriented firms.

   Location in a complex of related firms also provides opportunities for consulting; these opportunities are particularly important for those founders who quit previous jobs with no specific plans for the future and who need to support themselves while plans are crystallizing and capital is being raised.

6. Some, but by no means all, of the major complexes of new firms have grown up around universities--such as in Boston, Palo Alto, and Ann Arbor in America. Some universities, and particularly their contract research laboratories, have functioned as incubators, with students or staff spinning off to start new firms.

   However, a variety of other patterns also exist. In Palo Alto, only 6 of 243 firms founded in the 1960's had one or more full-time founders who came directly from a university. In that complex, the role of the university as an incubator appears to have been relatively more important in the earlier years. In both England and America, there are universities strong in science and engineering which have been associated with very little entrepreneurship. There are also instances of substantial entrepreneurship without the presence of a strong university. One study found that of 22 technical complexes studied, only 7 had major universities. Several had no universities when the technical company formation process was getting started.

Universities have undoubtedly played a role in attracting able young men and women to particular regions, and sometimes in giving the firms located there competitive advantages in recruiting and retaining these people. They also provide sources of consulting assistance and opportunities for continuing education for professional employees. Their relative importance as incubators appears to vary not only by university and by geographic area, but also by technology. For instance, university spin-offs are relatively more important for bio-engineering than for firms based upon mechanical engineering technology.

7. There is considerable evidence that specific programs intended to help entrepreneurs have achieved some success. In the United States, the Innovation Centers at the University of Utah and Carnegie-Mellon University have reported 8 and 16 start-ups respectively. A program in the United Kingdom, conducted at four different universities, has been associated with the founding of 192 new firms. A number of programs intended to assist entrepreneurs have recently been started in various cities and states in the United States.

   In general, these programs have not been limited to students or faculty at the universities. The U.K. program was directed at experienced managers who had lost their jobs, often because their companies had gone through mergers or were shrinking. It involved careful selection of the prospective entrepreneurs, who were required to have at least an idea for a new business. A four-week educational program was followed by a twelve-week period in which ideas were investigated and business plans were developed. Accountants, bankers, and other professionals were involved in the program, so that the participants could form contacts and seek advice. Assistance, evaluation, and advice were provided not only by the faculty teams, but also by other participants in the program. As of 1981, the U.K. program had led to business start-ups by 76% of the participants; a total of 192 new firms had been formed, which had survived for at least one year. Total employment of these firms, as of 1981, was 1,609.

The Development of an Entrepreneurially-Active Area

How does an entrepreneurially active area develop? There have been few studies involving systematic comparisons between regions or of environmental influences as they change over time. However, research to date suggests that the following processes influence the regional climate for entrepreneurship.

If an area is to develop and maintain growth-oriented entrepreneurship, organizations which can serve as incubators must be present, be attracted, or be created. Since founders tend to start firms where they are already living and working, there must be organizations which will hire, bring into the area, and train the engineers and managers who may someday become entrepreneurs.

However, the nature of these organizations is critical in determining whether spin-offs actually occur. It is certainly not difficult to point to cities where thousands of engineers are employed, but where there is little entrepreneurship. Exhibit 3 indicates the characteristics of firms and the industries in which they operate which may be associated with high or low birth-rates of new firms.

Many regions have economic development commissions which try to attract branch facilities of large firms. The primary emphasis is upon number of jobs, usually factory jobs, which would be created. If regional entrepreneurship is to be encouraged, prospective organizations should be evaluated, not only in terms of immediate job creation, but also in terms of their promise as incubators.

It is interesting to speculate about whether incubator organizations can be created. Such organizations would probably be targeted at selected promising technologies. They would have to be good at recruiting and bringing to the area capable, amibitious young people; however, there should be incentives for them to leave at some point and to go on to something else, such as starting their own businesses.

We note that entrepreneurially active areas developed a variety of environmental conditions over time which are supportive to the starting of new firms. Examples of successful entrepreneurship and sources of advice and assistance develop. Financial institutions and individual investors become more attuned to working with new growth-oriented firms. Complexes of suppliers and customers may develop, thereby providing economic advantages to location within the area.

Is it possible to create, possibly through governmental policies, a climate more supportive to the birth of new firms? A number of countries, regions, and cities are experimenting to see what can be done. Institutions can be established which provide local sources of venture capital and managerial assistance. Short courses, weekend seminars, or more ambitious long-term programs, such as the one in the United Kingdom, can provide training and encouragement for prospective entrepreneurs.

It is by no means assured that programs such as those described will lead to the birth of growth-oriented firms. Prevailing societal attitudes toward business, the nature of the expertise of people already in a region, and the economics of location will influence what can be done.

However, if early success can be achieved, then those successful firms can help to change the environment. The entrepreneurs who come after may find a more favorable climate. As they then pursue their individual dreams, society can benefit from their hard work, their creativity, and their vitality.

ENTREPRENEURSHIP: SOME RECENT CONTRIBUTIONS IN THE ECONOMICS LITERATURE

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It is the purpose of this paper to survey contributions to the theory of entrepreneurship appearing in the economics literature over the period since roughly 1980.[1] It is organized primarily around certain issues which appear repeatedly in that literature. Before considering these, however, two contributions deserve special mention. The first of these, The Entrepreneur: Mainstream Views and Radical Critiques by Robert F. Herbert and Albert N. Link (1982), is a comprehensive survey of the way in which economists have perceived entrepreneurship from ancient times to the present which should be over-looked by no one with an interest in this subject. The second, The Entrepreneur: An Economic Theory by Mark Casson (1982), is a 400-page monograph on what an entrepreneur is, what he does, and especially how he does it, which is quite possibly unique in the economics literature in terms of its focus on the specific, operational tasks of entrepreneurship rather than its place in the economy as a whole.

What is an Entrepreneur?

As noted, certain issues appear repeatedly in the literature surveyed. The first of these is the definition of entrepreneurship. While this question appears to some extent in virtually every item examined, certain authors treat it in-depth, and it is these which are mentioned here. Some define entrepreneur while others define entrepreneurship. We will combine the two by letting an entrepreneur be simply one whose behavior is characterized by entrepreneurship. Having done this, we must state that no consensus exists in the literature as to what constitutes an entrepreneur.

Several writers hold, in effect, that entrepreneurship is little more than rational economic behavior in the context of uncertainty. Demsetz, for example, states that "Entrepreneurship is little more than profit-maximization in a context in which knowledge is costly and imitation is not instantaneous (1983, p. 277)." Schultz (1980) tells us that individuals who perceive and evaluate economic disequilibria in an effort to decide whether it is worthwhile for them to reallocate their resources (including their own time) are entrepreneurs. He states that workers, students, housewives, and consumers frequently act as entrepreneurs and, indeed, that "entrepreneurship is a pervasive activity in a dynamic economy (1980, p. 437)." In a similar vein, Baumol seems to hold that while entrepreneurship is not merely maximizing behavior amidst uncertainty, it is merely maximizing behavior of an exceptionally determined kind. As he puts it, "I use the term (entrepreneurship) to refer, loosely, to a person's exercise of imagination, alertness, and daring in the pursuit of his goals (1983b, p. 176)." Moreover, he specifically avoids limiting these goals to the realm of business (1983b, p. 176).

Even among those who see a more specialized role for the entrepreneur, there exists little consensus. What there is consists first of a general feeling that it is the role of the entrepreneur to perceive opportunity. Thus, Fellner states that, " . . . successful entrepreneurial judgements are in the nature of 'discoveries' or 'inventions'--essentially of discoveries of market opportunities . . . (1983, p. 31)." Kirzner tells us that " . . . the entrepreneurial function must necessarily always be that of sniffing out opportunities that on the surface do not appear to exist (1979b, p. 149)," and that "the entrepreneurial function is to notice what people have overlooked (1982b, p. 273)." Finally, Rosen writes that " . . . entrepreneurial activities must involve the organization of resources that are initially outside the existing market system" and that with entrepreneurship, "it is the creative idea which is the crux of the matter . . . (1983, pp. 303, 305)."

Another common view is that the entrepreneur must not only perceive opportunity but must also exploit it. Thus, Fellner states that in addition to judgements about opportunities, entrepreneurship involves " . . . achieving the acceptance of these judgments by economic agents (1983, p. 42)," Kirzner states that "entrepreneurship in the market consists in the function of securing greater consistency between different parts of the market (1982a, p. 153)," and Leibenstein includes among the activities of the entrepreneur such active tasks as gap-filling, obstacle-overcoming and input-completing (1979, p. 135).

Where disagreement arises is over the degree to which entrepreneurship entails the bearing of risk. According to one group, the risk of losing one's job is sufficient to meet this requirement, while a second requires the risk of bankruptcy. The former admits certain employees to the order of entrepreneurs while the latter limits it to residual claimants. Casson belongs to the first group. An entrepreneur, he states, is " . . . someone who specializes in taking judgemental decisions about the coordination of scarce resources (1982, p. 23)." Included among such individuals are salaried managers (1982, p. 350). Young would also include employees as entrepreneurs, apparently accepting the view that entrepreneurship is basically " . . . an organizing and promoting activity, which may be paid for by wages or other means . . . (1983, p. 23)" and citing numerous examples of employees performing entrepreneurial activities. Fellner, too, admits the possibility of employee-entrepreneur when he writes, "In most major enterprises, the entrepreneurial function is performed by many individuals, by some to a greater extent than by others (1983, p. 46)" and that, "Successful entrepreneurs usually earn their incomes in the form of favorable salary and retirement conditions and/or bonuses and stock ownership or stock options . . . (1983, p. 46-47).

In the second group are those such as Kirzner who states flatly that "to hire an entrepreneur is to be an entrepreneur (1980, p. 16)" and that "services that have been hired must be presumed not to be entrepreneurial (1979a, p. 174)." Bearse takes a similar position (though perhaps to facilitate the obtaining of an empirical sample) when he writes, "The entrepreneur of this study is someone who bears the risk and uncertainty of not receiving payment for work on a regular basis . . . (1984, p. 112)" and selects for his sample the set of "self-employed proprietors" and "self-employed incorporated" from the U.S. Bureau of the Census, *Survey of Income and Education*. Leibenstein also seems to take the position that employees are not entrepreneurs when he states that despite the possibility that the entrepreneur may choose to take his reward in the form of a job in the new organization, he must, nonetheless, bear (at least initially) the uncertainty of the organization and its environment (1979, pp. 136-137).

Many writers are silent, of course, on whether an employee can be an entrepreneur, and one of these deserves special mention. This is an article by Greenfield and Strickon in which they take an essentially biological view of the market process and define an entrepreneur as " . . . an individual who performs behaviors that are new in his community. In this respect he is a source of variation within that population (1981, p. 497)." In their view, the entrepreneur plays the same role in the economic process that mutation plays in biological evolution.

Why has Economics Ignored the Entrepreneur?

It is almost standard practice in the items examined to include a statement to the effect that mainstream economics has ignored the entrepreneur. Some writers explore the reasons for this. Baumol, for example, states that the reason entrepreneurial activity has generally eluded economic analysis is that by its very nature such activity cannot be standardized and described in general terms (1983a, p. 29) and defines entrepreneurial activities as " . . . those economic acts that are not subject to standardization and obey no systematic and persistent principles (1983a, p. 30)." Further, he states that should we ever be able to understand and teach a particular entrepreneurial activity, it would for that very reason cease to be entrepreneurial (1983a, p. 30). Casson is less pessimistic. In his view, there are two reasons for the lack of a theory of the entrepreneur. These are, first, the extreme assumption about information in orthodox economics which trivializes decision-making and leaves no role for the entrepreneur, and, second, the extreme subjectivism of the Austrian School which makes a predictive theory of the entrepreneur impossible (1982, p. 9). Demsetz (1983) has another explanation. In his view, the primary focus of classical and neoclassical analysis has been that of understanding how a decentralized economic system allocates resources, i.e., of understanding equilibrium prices and allocations. Economic change, the realm of entrepreneurship, was neglected because to consider it would have complicated the major problem. He thus cites three reasons for the neglect of the entrepreneur. These are, first, that the problem of understanding perfect decentralization doesn't require a focus on economic change, second, that problems of change which become important with imperfect decentralization are addressable without analytical appeal to entrepreneurship, and third, that problems of change associated with unforeseeable events are beyond the scope of analysis (1983, p. 278). He equates "pure entrepreneurship, " a la Kirzner, with luck and says it's been neglected because it's not yet been linked to a systematic behavioral response to uncertainty (1983, pp. 277, 279). A fourth explanation is given by Greenfield and Strickon (1981). Economics has been unable to successfully study the entrepreneur, they argue, because it, like all of the social sciences, has been locked in the essentialist/structuralist paradigm which does not handle the behavior of single individuals well and is thus not capable of handling the entrepreneur.

What Stimulates Entrepreneurship?

Another topic receiving attention has been the factors which encourage entrepreneurship.[2] Buchanan and Faith (1981), for example, explain how society's response to the externality problem can inlfuence entrepreneurship and conclude that a legal rule holding one liable for the externalities produced by his acts is less inhibiting to the entrepreneur than a rule prohibiting the externality in the first place. Fellner (1983) argues that a "long-run oriented" approach to public policy is conducive to entrepreneurship. Hughes (1980) presents an interesting discussion of the role of property rights in encouraging entrepreneurship in the early history of the United States. Education as a tool for promoting entrepreneurship is advocated by Schultz (1980) and Williams (1981) while Casson (1982) views it as having a very limited role and Baumol (1983) discounts it altogether. Several authors identify the distribution of wealth as a factor affecting entrepreneurship. According to both Kurz (1983) and Kihlstrom and Laffont (1979), one's level of wealth affects entrepreneurship by affecting one's level of risk aversion. According to Casson (1982), an individual without wealth faces a difficult task in obtaining financing for a venture without revealing so much about his idea that it will be stolen by a prospective financier. Baumol (1983) writes that the major impediment to entrepreneurship today comes from business people who want protection from competition. Williamson (1983) urges a more lenient anti-trust attitude toward organizational innovation inasmuch as a great deal of entrepreneurship takes this form as it aims at the reduction of transactions cost. According to Arrow (1983), small firms will generate more original innovations than large firms, while both Storey (1982) and Johnson and Cathcart (1979) tell us that small firms are more effective than large firms in incubating new entrepreneurs.

Commentary on Earlier Theories

As might be expected, several items have appeared the purpose of which is to comment on earlier contributions. In one such piece, Kanbur (1980) points out that Schumpeter systematically excluded risk-bearing as a part of the entrepreneurial function, arguing that all risk falls on the capitalist as the only one with something to lose. According to Kanbur, this view overlooks the opportunity cost of the entrepreneur in undertaking the project in question. High (1982) makes a comparison between the entrepreneurship theories of Kirzner and Mises, arguing that Kirzner's concept of "alertness" overlooks the concept of judgement upon which Mises placed great emphasis. Martin (1979) examines the views of Knight and Schumpeter as they concern the work of Carl Menger, concluding that Schumpeter's view of Menger was the more accurate and that Knight and Menger had similar theories of entrepreneurship. Reekie and Savitt (1981) compare the views of Wroe Alderson in marketing with those of the Austrian School and find the two to be similar. Casson (1982) discusses several earlier works and makes the interesting contention that the link between these theories and orthodox economics is to be found in the institutional theory of the firm. Finally, as noted earlier, the effort by Hebert and Link (1982) is in a class by itself insofar as the review and comparison of entrepreneurial theories is concerned.

How Does the Entrepreneur Function?

While many writers discuss what the entrepreneur does, few explain how he does it. Foremost among these is Casson (1982), the bulk of whose book is concerned with describing how the entrepreneur "makes a market" for his product, acts so as to minimize information costs, exploits the concept of the "internal market," and uses to advantage the resources available within his family and circle of associates. Other contributions in this area include the claim by Buchanan and Pierro (1980) that formal theories of probability contribute little to our understanding of the entrepreneur since this individual forgoes any calculus of expected utility and simply "plays his hunches" and the contention by Williamson (1983) that much entrepreneurial activity can best be understood as an effort to reduce transactions costs.

The Development of Formal Models

While it remains true that little in the way of formal modelling exists in the economic literature on entrepreneurship, some examples have recently appeared. One of these is by Kihlstrom and Laffont (1979). Basing their work loosely on that of Knight, they construct a general equilibrium model in which individuals choose whether to become entrepreneurs on the basis of risk aversion which explains the number and sizes of firms and the incomes of workers and entrepreneurs. They then explore the existence, uniqueness, and efficiency properties of the model's equilibrium. A second entrepreneurship-based general equilibrium model is that of Calvo and Wellisz (1980). In this model, one becomes an entrepreneur on the basis of their ability to acquire knowledge. The model explains the population of firms, the number and characteristics of entrepreneurs, and the distribution of income on the basis of the ability and age structure of the population and the rate of exogenous technical change. A third model is that of Littlechild and Owen (1980). Based loosely on the theory of Kirzner, the model explores the process through which prices in separate markets for a homogenous good move to equality through the actions of arbitrageurs. The speed of this adjustment is found to depend upon the characteristics of the arbitrageurs and the attractiveness to them of discovering the existence of new markets. Another recent model is that of Baumol (1983a). Arguing that while we cannot hope to explain what the entrepreneur does we can nonetheless analyze the factors which lead him to do it, he develops a model of the level of entrepreneurial activity in which a random level of autonomous innovative activity interacts with regulatory constraints imposed by those threatened by entrepreneurship in such a way as to produce a somewhat cyclical pattern of growth. As a final example of an entrepreneurial model, we should mention the work of Greenfield and Strickon (1981). While not formalized, this model presents an entrepreneur as one who introduces new forms of behavior into a community. Some of these new forms are compatible with the environment and persist while others disappear. Through this process of environmental selection, the entrepreneur generates the pattern of technological change.

NOTES

1. The scope of the survey includes anything on the theory of entrepreneurship appearing in an economics journal or appearing elsewhere but written by an economist during the period surveyed. While an attempt has been made to make it comprehensive (roughly 600 items were considered), sources have undoubtedly been overlooked which were not quoted and whose titles were not indicative of their content. Moreover, due to the central role of entrepreneurship in the market process, many were surely also excluded which touch the subject briefly as they examine something else. It is, nonetheless, felt that it gives a good overview of what economists have written recently on the subject. As noted, the survey covers only the theory of entrepreneurship. Works by economists on the other entrepreneurial topics are not discussed but have been included in the bibliography.

2. This segment of the paper reflects only the discussion of this topic in contributions focused primarily on entrepreneurial theory. There are additional articles focusing directly on factors promoting entrepreneurship, but these were not surveyed.

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IDEOLOGIES OF ECONOMICS: SCIENTIFIC REVOLUTION AND THE ENTREPRENEUR

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The Theoretical Firm and the Entrepreneur

Economics, as a separate field of inquiry, has undergone a number of changes since a group of writers known as the mercantilists suggested policies to advance their nations' interests in the competition with other states for economic supremacy. If the acquisition of a paradigm signifies the maturation of a scientific field, then economics reached adolescence with physiocracy, which marked the beginning of analytical economics.[1] Adulthood was attained with the publication in 1776 of Adam Smith's *Wealth of Nations*. Following the articulation of classical economics by men such as Smith, Thomas Malthus, David Ricardo, and John Stuart Mill, the economics paradigm was modified in the 1870s with the advent of marginalism. Marginalists introduced the concept of incremental change into economic analysis. They were primarily interested in studying how resources are optimally allocated and how income shares are determined. Alfred Marshall synthesized the marginalist's utility centered analysis with the Ricardian cost oriented analysis and began a new paradigm known as neo-classical economics. This paradigm was, in turn, challenged in 1936 with the publication of Keynes' General Theory. The Keynesian paradigm's main points of departure from neo-classical economics were a rejection of Say's Law, and a treatment of money demand which gave a special prominence to fiscal policy as a positive force affecting the real sector of the economy.

The economics paradigms of mercantilism, physiocracy, classical economics, marginalism, neo-classical economics, and Keynesian economics have been consistent in at least one respect. The entrepreneur, who is the driving force in a market economy, has remained a "shadowy entity" in the theoretical firm. Richard Cantillon, who was first to use the word entrepreneur, defined an entrepreneur as someone who buys at a certain price so that he can sell at an uncertain price. Seventy years later, J. B. Say classified the entrepreneur as someone who organizes other resource factors in order to realize a reward that is uncertain. Following Say, the entrepreneur's role in formal theory virtually disappeared before being reactivated by Frank Knight (1921) and Joseph Schumpeter (1936).[2] Other than in the writings of Austrian economists such as Ludwig von Mises and Israel Kirzner, the entrepreneur has again disappeared into the theoretical woodwork. Recent authors writing about innovation and entrepreneurship, such as Peter Drucker and sociologist George Gilder, have infused the entrepreneur with new life.[3] The economics profession, however, still has not incorporated him into their formal analysis; the theoretical firm continues to operate without the services of an entrepreneur. Most of the remainder of this essay will address two factors which partially account for this omission. First, there has been a misunderstanding by some economists, and a neglect on the part of other economists concerning how wealth is created. Second, contemporary economists may be reluctant to reject the Keynesian paradigm because the opportunity cost of doing so may be too high. The essay ends with a brief discussion of several developments that might be made possible if a new paradigm in economics were constructed around the concepts of productivity and capital formation.

The Creation of Wealth

An idea that has permeated social history, and that has led many societies to try to rid themselves of the scourge of riches, is the principle that wealth causes poverty.[4] In this view, society is seen to be a zero-sum game; one man's riches can only come at the expense of others. George Gilder tells us that this idea continues to be popular in America's prisons and at Harvard. Unfortunately, many economists outside of Harvard have embraced this thinking over the years.

Mercantilist, bullionist, and cameralist writers of the 16th-18th centuries believed that a nation's wealth came from its possession of gold. State policy should therefore be directed toward accumulating gold and other precious metals. Because the total supply of gold was seen to increase slowly over time, it was felt that a nation could only gain wealth at the expense of another nation. Policies promoting a favorable balance of trade were supported by the mercantilists, while the outright prohibition of gold exports was favored by the bullionists. If this view of wealth had been accurate, then Spain's colonizing ventures in Latin America should have given it a natural advantage over other states in the race to become developed. In fact, as the amount of silver flowing into Spain slowed from a flood to a trickle, Spain's economy became as anemic as it had been before the colonial excursions which had augmented its purchasing power. During the same period, other parts of Europe, which had not been able to rapidly accumulate riches, flourished because of saving and investment activities.[5] In a 1692 treatise, Discourse about Trade, Dudley North was the first to correctly point out that a country's wealth is not the same thing as its stock of silver and gold. He also advanced the proposition that trade, rather than being a zero-sum game, is an activity which yields benefits to all trading partners.[6]

The physiocratic paradigm sought to explain the creation and distribution of wealth in a world that was believed to conform to laws of natural order. This system, which is usually associated with the work of Francois Quesnay, advanced the proposition that laissez faire, laissez passer should be a guiding principle for government policy makers.[7] If legislators could be prevented from upsetting the laws of nature, then abundant wealth would be made possible in the form of increased production. The physiocrats did not regard middlemen and financiers as creators of wealth. They were seen to be dealers of items which had value as a result of the previous efforts of primary goods producers.

Although Adam Smith agreed with the physiocrats that a nation's wealth consists of its produced goods, he broadened the scope of productive activity to include many categories that the physiocrats had deemed to be unnecessary. The economics of Adam Smith was the economics of optimism and of freedom. In holding a state's activities to a minimum, self-interested individuals, constrained by the forces of competition, would increase national wealth and thereby increase the demand for labor. Smith believed that the long-run trend of real wages would be upward; mass produced goods would mainly benefit the masses.

Classical economists following Adam Smith were pessimistic concerning the future economic well-being of those living in even advanced economies. Thomas Malthus reasoned that nations would experience an arithmetic increase in food production, while population could be expected to grow geometrically. These disparate growth rates would eventually push standards of living down to starvation subsistence levels. Thomas Sowell notes that Malthusian theory, which he believes has been refuted more thoroughly than any other theory in the social sciences, was an exercise is deductive logic devised to counter the political theory embodied in philosophical radicalism.[8] As the influence of William Godwin and Marquis de Condorcet waned, Malthus greatly modified his suggestions concerning human behavior. Later editions of his Essay on Population focused on the moral justification of existing institutions. Notwithstanding the reasons underlying its origin, Malthusian economics was accepted by many influential thinkers of the time, and it set the theoretical tone for a science which had suddenly become "dismal."

David Ricardo was mainly concerned with how factor shares are determined when total income is fixed.[9] In his theory of the stationary state, Ricardo implicitly assumed a given level of technology, a constantly growing level of population, and diminishing returns in agricultural production. Ricardo concluded that as progressively less fertile land is used, food prices and rents will rise. The proportion of national product going to landlords will increase at the expense of those earning wages and profits.[10] Perhaps Ricardo's failure to see that the productivity of labor is increased by the use of machinery, contributed to his belief that capitalists and wage earners were adversaries in a market economy.

John Stuart Mill, in his refinement of the static analysis of other classical economists, distinguished between the production of output and its distribution. In doing so, he implied that productivity and income shares can be independently determined without having a deleterious effect on the future level of a nation's wealth. Mill's work no doubt continues to inspire advocates of schemes to inventively fill in the blanks of the phrase "from each according to his ____, to each according to his ____."

Marginalists and neo-classical economists continued the tradition of ignoring wealth creating processes. For example, Walras' concept of general equilibrium applies to a static economy. While Alfred Marshall recognized the importance of understanding how and why economic decisions change over time, his analysis was generally conducted within the framework of a stationary state for reasons of analytical convenience.

Finally, the Keynesian paradigm, which has ruled the academic rookery since 1936, continues to embody a short-run conception of how the world works. Rather than concerning themselves with understanding how wealth is created, Keynesian economists are more likely to be pondering how fiscal policies can be more effectively used to redistribute income and wealth.

The Opportunity Cost of Scientific Revolution

Just as an idealogue, in the words of George Orwell, "thinks in slogans and talks in bullets," the contemporary economist thinks in paradigms and talks in equations. There are certain similarities between an ideology and a scientific paradigm. For example, both are knowledge-economizing devices. An ideology explains complicated processes and events by using common and simple variables;[11] chanting slogans requires little intellectual capital. Similarly, a paradigm drastically reduces the range of admissible variables, the interaction between these variables, and the questions which may be legitimately addressed by the paradigm's practitioners.[12] Indeed, without some restrictions, science would not be possible; collecting data would be a random activity. Both ideologies and paradigms change by revolutionary rather than evolutionary processes. Ideologues are notorious for their tendency to ignore data that contradict their notions of how the world works. Opponents of an ideology may be viewed as being manifestly stupid or marked by malice.[13] It is interesting that ideologies appear to be most appealing to those groups whose opportunity cost of knowledge is high, such as the young and apathetic.[14] As noted by Sowell, supporters of an ideology accumulates so that the opportunity cost of discarding the vision is less than the cost of rationalizing the discordant observations.[15] The socialist dream, for example, has begun to fade for all except those leftist intellectuals in universities and parish parlors who have neglected to calculate the probability that one country can have more than 60 years of bad weather in a row. Continued support of an ideology in the face of massive discordant data can only be described as an act of faith; it is based on future promise rather than past achievement. Thomas Kuhn has argued that scientific paradigms also change through a revolutionary process. Normal science, which guides research in an orderly fashion, is usually inimical to fundamental novelties which may subvert the premises of a prevailing paradigm. Influential intellectuals, who have invested a great deal of time and effort in working out the puzzles of a prevailing paradigm, may simply ignore anomalies that cannot be addressed within the given scientific framework or that are not consistent with a paradigm's predictions. Young intellectuals or thinkers new to a field whose opportunity costs of rejecting a paradigm are low, will be more likely to offer alternative versions of a theory which explain away a prevailing paradigm's anomalies. As the number of versions of a theory proliferate, and the prevailing paradigm is blurred, the rules for normal research are loosened.[16] If a new paradigmatic candidate emerges, then there will be a battle between its adherents and intellectuals supporting the prevailing paradigm. The scientific revolution is complete when a profession embraces a new paradigm with its new set of commitments, problems, and proposed solutions.

For two hundred years, economic paradigms have, for the most part, featured the increased use of mathematical analysis in the study of complex social processes. Since physical laws were discovered to be discernible through experimentation and observation during the century of Enlightenment, economists have attempted to discover social laws and to depict them in systems of equations. The problem is that mathematical precision is not compatible with uncertainty and choice; demonstrative proof cannot be achieved without the rejection of time.[17] The theoretical firm is portrayed as making mathematical calculations in order to maximize profits. If exogenous factors do not disturb the firm's external environment, then price and output decisions will be duplicated ad infinitum.[18] Thus, the major opportunity cost of positing deterministic algebraic expressions is that the entrepreneur cannot be incorporated into the theoretical firm; managers can only react mechanically to changes in circumstances over which they have no influence.

Future Paradigms in Economics

Aristotle tells us that it is the mark of a trained scientist not to try to exact more precision in the treatment of a subject than is allowed by the nature of the subject.[19] This wisdom has been ignored by economists as they have increasingly tried to fit complex social processes rife with risk, uncertainty and change onto the Procrustean bed of mathematical analysis. Some economists have argued that mathematics is useful in theoretical disputes in the same way that cavalry is useful in battle; it adds tone to what otherwise would be an unseemly brawl. The leading practitioners of the current dominant economic paradigm are not using mathematics to add tone to their analysis; they are using it to paint by the numbers. The inability to adequately treat uncertainty and choice using deterministic algebraic expressions has even led some economists to conclude that "time is alien to reason."[20] As long as this attitude prevails, there will be no room in the theoretical firm for the entrepreneur; we will, according to Baumol, be forced to continue to discuss Hamlet without the presence of the Prince of Denmark.[21] Thus, the next paradigm in economics will have to achieve logical clarity with less reliance on mathematical exposition.[22]

Because wealth creation has much to do with productivity and capital formation, and since these events occur in a microeconomic context, the next economics will likely be microeconomic with an emphasis on supply.[23] The concept of profit will be rejected because "it assumes a static, unchanging, closed economy."[24]

Focusing on productivity and capital formation will enable economics to evolve in new and interesting directions. For example, the theoretical firm will require the services of an entrepreneur who is a dynamic optimizer rather than a static maximizer. Because productivity and capital formation are events of both a microeconomy and a macroeconomy, it should be possible to integrate microeconomics and macroeconomics into one theory. Since the advancement of productivity derives from purposeful human action, the new economics could conceivably develop a theory of value based on human knowledge and work. This would make it possible to combine moral philosophy and rigorous science. Such a development would extend the work begun by Adam Smith over 200 years ago. As a moral philosopher, Smith's key insight was that if it is moral to raise the masses from a position of abject poverty by providing them with the means to purchase material goods, then the market system, which places little emphasis on moral intentions, is a moral system because of its outcomes.

As a new economics becomes a normal science with its new puzzles to be solved, and its requisite set of policy prescriptions, practitioners of the paradigm will do well to remember another observation made by Smith and developed by Carl Menger in the 19th Century and Friedrich Hayek in the 20th Century. Many of the beneficient features of capitalism have not been the product of human design. Rather, they have developed spontaneously in a world made up of purposeful, self-interested individuals making choices in an environment characterized by risk, uncertainty, and change; freedom and efficiency go hand-in-hand.

NOTES

1. Kuhn defines a paradigm as a pattern of ideas that attracts a faithful group of followers from alternative patterns of ideas, and that creates problems or puzzles for the paradigm's adherents to solve. See Thomas S. Kuhn, The Structure of Scientific Revolutions, (Chicago, IL: The University of Chicago Press, 1962), p. 10.

2. Frank H. Knight, Risk Uncertainty and Profit, (Chicago, IL: University of Chicago Press, 1971) and Joseph Schumpeter, The Theory of Economic Development, (Cambridge, MA: Harvard University Press, 1936).

3. Peter Drucker, Innovation and Entrepreneurship, (New York, NY: Harper and Row, 1985), George Gilder, Wealth and Poverty, (New York, NY: Basic Books, Inc., 1981), and Idem, The Spirit of Enterprise, (New York, NY: Simon and Schuster, 1984).

4. See Chapter 9 of Gilder, Wealth and Poverty.

5. Ibid., p. 48.

6. Ingrid Hahne Rima, Development of Economic Analysis, (Homewood, IL: Richard D. Irwin, Inc., Fourth Edition, 1986), pp. 35 and 38.

7. Ibid., p. 51.

8. Thomas Sowell, Knowledge and Decisions, (New York, NY: Basic Books, Inc., 1980), pp. 341-343.

9. Rima, pp. 129-151.

10. Smith, Malthus and Ricardo did not distinguish between interest and profit. Ibid., p. 91.

11. Sowell, p. 309.

12. Kuhn, pp. 5-6.

13. James Burnham, Suicide of the West, (New Rochelle: Arlington House, 1964), p. 100.

14. Sowell, p. 309.

15. Ibid.

16. Kuhn, pp. 70-84.

17. G. L. S. Schackle, Epistemics and Economics: A Critique of Economic Doctrines, (Cambridge: Cambridge University Press), p. 255.

18. See William J. Baumol, "Entrepreneurship in Economic Theory," American Economic Review 58, (June, 1968).

19. Aristotle, The Nicomachean Ethics, trans. J. A. K. Thompson (New York, NY: Penguin Books, 1953), p. 65.

20. Schackle, p. 151.

21. Baumol, p. 66.

22. That this can be done with great force may be seen in Ludwig von Mises, Human Action, (Chicago, IL: Contemporary Books, Inc., Third Revised Edition, 1963).

23. This section draws heavily from Peter Drucker, "Toward the Next Economics," in The Crisis in Economic Theory, ed. Daniel Bell and Irving Kristol (New York, NY: Basic Books, Inc., 1981), pp. 4-18.

24. Ibid., p. 14.

ENTREPRENEURIAL FAILURES: RESULTS FROM A STUDY OF BUSINESS BANKRUPTCIES IN MINNESOTA

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Introduction

"Entrepreneurship" is a very popular topic. Since 1980, the number of its citations in periodical guides has more than tripled. This popularity is also seen in the surge of college-level courses in entrepreneurship. Entrepreneurship conjures up thoughts, articles, courses, lectures and testimonials about start-ups, stock offerings, venture capital, economic growth, private enterprises, and others. The focus generally is on successful businesses and their founders. Clear evidence of failure lies in bankruptcy, the topic of this paper.[1]

This paper concerns a 1985 research project on business bankruptcies in Minnesota. This project was the core of a special seminar course on "failures" in Macalester College's Entrepreneurial Program. It was taught by the author. The objective of this course was to analyze "mistakes" for insights into the keys for successfully launching and growing a harvestable business. The course included:

- A survey of the literature on entrepreneurship, as it related to success and failures,
- Analysis of 50 responses to 453 questionnaires mailed out to businesses that filed for bankruptcy in the Minneapolis-St. Paul area between March, 1984, and March, 1985 (11% response rate),
- Detailed case studies on 10 of the 50 respondents including interviews, and
- Presentations by a banker, a corporate turnaround expert, an attorney, and a bankruptcy judge.

Literature

If entrepreneurship concerns the dynamic process of creating incremental wealth,[2] then bankruptcy concerns the antithesis of success and symbolizes incremental wealth destruction. The literature is full of hypotheses for and explanations of failures.[3] Yet, there is little research supporting the explanations.[4] Most of the causes cited are relatively well-known or obvious, but too broad to be meaningful for an entrepreneur. For example, among the 20 causes listed by one author[5] were such obvious ones as a downturn in the business cycle, and such broad ones as "poor overall management."

Models from economics have been used for years. These include studies regressing failure rates on economy-wide variables (e.g., unemployment rate and interest rate), or on firm-specific variables (e.g., debt to equity or current ratio).[6] These tend not to look at the step by step analysis of failures. Thus, this project and paper do not focus on those studies. Instead, explanations from the entrepreneurial literature as well as business failures and turnaround literature were culled.

The major principles and generalizations from this literature include (in no particular order):

- Ease of entry. As one author wrote, "There is not much to stop them."[7]
- Bad Management.[8] This very broad category, sometimes also referred to as "sleepy management" or "pilot error," includes such characteristics as incompetence, impulsiveness, lack of managerial experience, unbalanced experiences, and so forth.
- Neglect of accounting information and procedures, or a lack of response to a change. For example, the firm may have over-traded, launched new projects that went under, and/or increased the leverage unwisely.[9]

NOTES

1. Kuhn defines a paradigm as a pattern of ideas that attracts a

- Uncertainty.[10] Entrepreneurs sometimes fail as they try to adjust to disequilibria.
- Undercapitalization.[11] This can be either an excuse or a real problem. It could occur at the start-up or during rapid growth, which can eat up cash-flow and cause a fatal stall.
- Choice of product or service.[12] The timing may have been wrong, but probably there was lack of both significant sales potential and a positive profit margin.

The literature offers models which can be modified for examining failures. These are the flip-sides of models for entrepreneurial success. For example, Timmons offers a simple paradigm called "The Entrepreneur's Cube."[13] The fit of a venture and its potential (i.e., potential volume of success) are represented by: $V = E \times O \times R$. The E is for the entrepreneurs and represents the experience and quality of the entrepreneurial team. The O is for the opportunity in question. It represents the evaluation and screening of ideas for potentially successful ones. The R is for the resources required to launch and sustain the venture. A venture's demise could then be related to problems with the entrepreneur including

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lack of experience, a weak opportunity, and/or insufficient initial capital resources to start a venture and weather the storms.

Seldom mentioned in the literature, but receiving more than passing reference by the experts we interviewed from the bankruptcy industry were:

- Dishonesty, drinking problems, undependable . . .
- "Shark Repellent," which is that the bankruptcy was filed in order to avoid onerous lawsuits or contracts.
- No network of friends, customers, mentors, or contacts.
- Misdirected promotions (e.g., ads in the wrong media)
- Focus on sales and not profits ("soup with no contents")

Questionnaire Results

We mailed a questionnaire to 453 businesses from the Twin Cities, whose names appeared in a weekly column on "Business Bankruptcy" of the Minneapolis Star and Tribune between March, 1984, and March, 1985. The questionnaire was designed to probe three areas: History of Business, Background on the Owner, and Perceptions of the Owner. We received only 50 responses (11%). Therefore, we must warn our sample may not yield statistically significant results. Our results from this part of our project are summarizecd in the Tables below.

Table 1

Selected Formative or Pre-Failure Characteristics
of the Owner/Operator of the Failed Business

Characteristic	% Yes
Sole owner?	68%
Male?	82%
Median age bracket?	41-50 years
Married?	66%
Median years of formal schooling?	13-15 years
Parents owned a business?	50%
Foreign-born?	4%
Only child?	12%
Median number of full-time jobs before owning/operating this business?	3 jobs
Employed in a firm of 100 or more employees before this business?	43%
Owned at least one other business before this business?	36%

Previous Business Experience	Self-rated as "Significant"
Marketing/Sales	69
Operations/Manufacturing/Productions	48
Finance/Accounting	40

Table 1 begins the analysis by reviewing some of the formative or pre-failure characteristics of the owner-operator. Since about two of every three businesses we studied were owned by one person, we have an indication of a lack of breadth. We also found that two-thirds of these businesses were run by first-time owners. They likely would not have acquired experience from going up the learning curve in a previous business. The E in Entrepreneur's Cube has only one root, and does not appear to be very deep.

These people had a surprising amount of work experience (3 jobs or more), perhaps attributable to their relatively older age (median bracket of 41 to 50 years). Their most significant work experience was in Marketing/Sales. Their relatively weakest area was in Finance/Accounting. The Marketing vs. Accounting difference is consistent with the literature and our expectations. Significant marketing experience perhaps could lead one to be rather confident in starting a business, but mask weak financial controls.

Table 2

Selected Characteristics on the History of the Business that Filed for Bankruptcy: 1984-1985: N = 50

Characteristic	% Yes
Started by the owner/operator?	76%
In a price-competitive business?	72%
Had fewer than six employees?	64%
Personal savings was the primary source of start-up financing?	55%
Corporation?	45%
In food, restaurant, bar industry?	16%
Owned, not rented, building or property of business?	15%
Filed Chapter 7?	70%
Current in paying taxes when business filed?	60%
Median bracket showing self-reported amount of money lost in this business by the owner/operator	$50,000 to $100,000

Table 2 profiles the history of these businesses. About three-fourths were started from the ground up. Most were owned by first-time entrepreneurs. Nearly 75% reported they were in a price-competitive business. Increases in prices and subsequent margin enhancement would not work. Thus, attention to cost reduction as a means to positive margins would be important. The relatively weak experiences of these respondents in finance/accounting shows this route to margin enhancement could be difficult.

About two-thirds of the failed businesses had fewer than six employees. More than half were sole proprietors rather than corporations. This also is seen in the fact that most went directly to liquidation (Chaper 7) rather than to reorganization (Chapter 11).

Both the personal testimonials and the lectures of experts in the industry detailed the sometimes frantic steps taken before the bankruptcy filing to raise or conserve on cash. Bills are not paid. These data show 40% were behind in paying Federal withholding, unemployment, and/or State sales taxes.

Table 3

The Similarities Between 890 Survivors Who Started Their Own Businesses and 50 Failures Who Filed for Bankruptcy

Selected Characteristics	890 Survivors Who Started Their Business (1979)[a]	50 Failures Bankruptcy in Minn. (1985)
Parents owned business	50%	50%
Education: College or more	42	42
Number of full-time jobs before this venture was two or less:	34	36
Age at questionnaire was:		
30 or less	36	18
41 or more	25	48
Prior organization had under 100 workers:	63	56
Most important source of original financing was personal savings:	59	54

Note: [a] Cooper et al., 1981, pp. 8 and 11.

Table 3 shows several major areas where we found very little difference between the responses of our failure group and responses of 890 entrepreneurs in surviving businesses from a study by Cooper.[14] The one difference is age; the failure group is older. If age and maturity, wisdom, or experience are positively correlated, then we have a puzzling result.

Table 4

Respondents' Explanations for Failure, and Selected Attitudes, Feelings, and Perceptions of the Owner/Operator Regarding the Time Period Immediately Prior to the Bankruptcy Filing

Most-Cited as "Significant"[a] Reasons for Failure[b]		Most-Cited as "NOT Significant" Reasons for Failure	
Undercapitalized	81%	Too dependent on one employee or one customer	83%
Inadequate sales/ Sales decline	71	Employee dishonesty	77
Economy as a whole	57	Unsupportive family	76
Unfavorable terms on borrowed money	42	Inadequate accounting/ Record keeping	72
Lack of planning/ Poor business concept	38	Inappropriate marketing/ Advertising	62

Percentage Who Thought Business Probably Could Be Turned Around:

One year before bankruptcy	85%
At time of bankruptcy	35%

Contracted, Listened To, and Relied Upon When Going Under:

Lawyer	26%
Accountant	23
Banker	15
Business Assistance Organization	10

NOTES: [a] Significant includes those who checked "Very Significant" and "Significant"; Not Significant includes those checked "Not Very Significant" and "Insignificant".
[b] Respondent could check more than one explanation.

Table 4 reports the entrepreneur's responses to a number of queries about the degree of significance they attached to a number of alternative, hypothetical explanations for the business' failure. The two significant factors cited by the owners in causing the failure were undercapitalization and either not enough or declining sales. These results were not surprising even though they are somewhat tautological given the meaning of bankruptcy.

The literature shows undercapitalization is nearly always a contributing factor, and the business is usually undercapitalized from start-up. However, insufficient capital after the start-up could be due to internal growth or growth-by-expansion to other lines. Our detailed interviews revealed that lack of sales for the plant size and cost structure in place was overwhelming.

One year before filing for bankruptcy, 85% of the owners thought their business could be saved. By the time of the bankruptcy filing, this had plummeted to 35%. It is surprising that about one-third of them thought they could still turn it around at the time they filed for bankruptcy. For advice and counsel in the period immediately prior to the bankruptcy, the respondents relied on their attorney and accountant. Only a handful used the services of a business assistance organization.

Table 5

Selected Owner/Operator Impressions When "Looking Back"

"I wish I had . . . "	
Known more accounting and finance	62%
Known more marketing and sales	49
Known more management and operations	40
Never even started this business	32
Worked harder	30

We thought it would be interesting to examine how the owners felt in hindsight. We asked them the extent to which they agreed or disagreed with a series of statements beginning with: "I wish I had." Table 5 shows some of these results. Earlier we saw 72% reported their relatively insignificant accounting/finance background was not a significant cause of the failure. Yet, the highest-scoring "I wish I had" was the 62% who wished they had known more about accounting. Most were not negative about their business experience. Only one-third wished they had not even started it.

Of the 50 respondents, 25 reported the bankruptcy strained their personal lives. The cause and effect issue is an obvious one, but the intertwining of professional and personal lives is one we all are sensible to. Splitting the sample into these two groups of 25, we found those reporting a strained personal life were slightly more educated, more likely to have used other people's money rather than their own personal savings, and to have owned rather than leased their fixed assets.

Review of Bankruptcy Court Records

We sent to the U.S. Bankruptcy Court, District of Minnesota, with the case file numbers from our survey. The file could be examined on site. The filing petition for a typical case was a voluntary, Chapter 7 petition by the individual. It included the name of the proprietorship. A listing of such things as all assets, debts, and the wage and employment record of the proprietor were included.

Reading the files reveals clues to a failure's cause. An example was a 3-chair, downtown beauty salon taken over by a woman proprietor in late 1982, and subsequently moved to a different location in 1983. There was a $299.69 debt to a hospital for maternity services incurred in February, 1983, by the proprietor. That bill has been turned over to a bill collector, and later a judgement was entered in February, 1984. Another $240.63 bill for office visits to a medical clinic for the February 1983-October 1983 period was included in the petition for bankruptcy filed in March, 1984. The obvious hypotheses, later confirmed in the interview, but not evident in her responses to the questionnaire, were that the proprietor must have been away from work for a long period of time ("Who ran the business?"), there was no health insurance policy ("Contingency planning?"), the timing of the baby and the takeover of the business were not in synch, and avoiding the bill collectors and judgement hassles (and, the diversion of efforts from the business) drives one to seek the "shark repellant" bankruptcy offers.

Case Studies

Of the 50 respondents, over 20 volunteered to speak to students and serve as a case study. There were 10 students in the seminar. Each chose one. Half of these came to the class, and we were surprised by what we uncovered in the classroom interviews.

Table 6 summarizes major causes of failures we identified from the 10 case studies. Typically, there were at least three factors for each business which were highly correlated with its failure.

Table 6

Causes of High Correlates with Business Failures in 10 Interviewed Case Studies from the 50 Repondents

Causes or Correlates, Briefly Described	Type of Business (see key)
"Fell into the business" or from employee to owner with no planning or too quickly	B, C, A, M
Poor location or lost the location or plant site wrong size for location	B, R, R1, R2
Inappropriate timing on starting the business, or "Jumped through a closed window", or forced into missionary selling	B, EM, D
Poor quality product, returns and law suits	EM, CM, RMS
Questionable ethics, transient entrepreneur, chemical dependency problems	EM, M, R2, A
"Doubled down", i.e., expanded the business in a risky direction or manner after knowing that the core business was trending down or in trouble	D, R, RMS
Personnel: Too many, all from the family, did not delegate	CM. RMS, R1
Market changes, change in technology, economic downturn	R, D, RMS

KEY:

B = Beautician; EM = Equip. Manuf.; D = Developer; R = Resort;
M = Meat; CM = Computer Manuf.; R1 = Restaurant #1; R2 = Restaurant #2;
RMS = Roofing Manuf. Sales; A = Auto Repair

Each owner had a unique and often bizarre story to relate to us. The story was not evident from reading the questionnaire. Although 77% had said that employee dishonesty was not a significant cause of failure, shades of questionable business and personal ethics by the owner were significant in 4 of the the 10 failures. Many led us to believe they participated in the underground economy. This includes not reporting income, taking cash from the register, not paying worker's compensation, using business assets for personal consumption, and so forth. Several acknowledged chemical dependence problems, and discussed their marital problems.

There was strong failure cause or correlation in what we termed "doubled down," a term from the card game of blackjack. The core business would be slipping or stagnant, and the entrepreneur would launch off in another new area for the business. For example, the condo-project developer with slow sales began a fatal project of converting an old building to a mini-mall project; or, a roofing contractor moved vertically into acquiring and carrying as inventory substantial amounts of foreign-made, roofing materials. This exposed the firm to technological change (obsolete material) and to foreign-exchange risk.

The interviews brought out the problems of poor products and service. It also showed the connection of this to key employee compensation. Several businesses paid workers commissions or bonuses on sales, and these sales later were returned, or future sales were forever lost, or law suits begun due to product quality problems. Some entrepreneurs may have offered good products or services, but chose a poor location or inappropriate firm size. For example, one woman started a restaurant, but only considered one site, where a previous restaurant had been located and failed!

Concluding Remarks

The literature on failures including short sections in many small business and entrepreneurial books is neither well-developed nor uniformly consistent in listing and explaining the causes of failures. Generally available data on bankruptcies are not rich enough to provide the multiple, base-line explanations of failures. Industry practioners are aware of many of those keys, for they have seen many cases and the patterns.

We believe case studies, including both a review of court documents and live interviews with the entrepreneur, provide a better basis than answers to questionnaires. We believe the literature on small business failures is quite devoid of such important causes as personal ethics, chemical dependency, and family relations. It does not focus on the damage to a business' survival potential from selling faulty products. We believe using the paradign such as: V = E x R x O, to examine the failure in focusing on the underlying causes.

While the literature focuses on lack of working capital, seeing how firms get to a "lack of working capital" makes deep impressions on students. For example, one of our case study entrepreneurs took over, refurbished, and expanded a resort. His subsequent divorce followed shortly thereafter by severe leg injury forced him to write at least three regular, periodic checks: his ex-wife, the employee who replaced her formerly unpaid services, and the employee who replaced his formerly unpaid services. Deferred maintenance began and his capacity to borrow was impaired. These factors caused a "lack of working capital," and he could not recover.

That case and many others point out what we called the "weak shocks effect:" The small, entrepreneurial businss has a difficult time withstanding business pot holes. Ease of entry was another major cause. If the entering price is low, many will enter. In a competitive industry, there is very little room for error by a firm with relatively high costs.

A bankruptcy marks the end of a business (Chapter 7) or the end of one way in which the business operated or existed (Chapter 11). It is a failure in that some incremental wealth was lost. On the other hand, the entrepreneur may be able to lever the experience to future successes. One visiting venture capitalist told us he likes investing in a business with an entrepreneur who previously failed, but only if the person learned from the causes and the process. Some of our guests called it a great education. Perhaps their human capital wealth expanded more than their loss of monetary capital. But what about the others who lost?

NOTES

1. One could argue that a bankruptcy is not a failure. That debate is not within the scope of this paper.

2. Ronstadt (1984), p. 28.

3. See the "References", this paper.

4. The work by Gill (1985), Bibeault (1982), and Platt (1985) are exceptions to this.

5. Barrickman (1979), p. 28.

6. For example, see Altman (1968), p. 590.

7. Siropolis (1986), p. 13.

8. See, for example, Dun and Bradstreet (1985); Bebeault (1982), p. 86; and Sondeno (1985), p. 18.

9. Argenti 91976), p. 108.

10. Herbert and Link (1982), p. 109.

11. Timmons (1985), p. 141.

12. Vesper (1980), pp. 29 and 107.

13. Timmons (1985), p. 141.

14. Cooper and Dunkelberg (1981), pp. 8 and 11.

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CREATING AMERICA: THE ENTREPRENEURSHIP OF BEGINNING

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The American economy got a late start even by the standard of the Western Hemisphere. A full century elapsed after Columbus before Europeans began serious efforts in the area which now incorporates the eastern seaboard of the United States. They had explored the coast enough to have a rough idea of what the region offered but high transportation costs stifled likely enterprises.[1]

About 1600,European entrepreneurs reconsidered America. English trading ventures in India and Russia had recently yielded extraordinary returns, in excess of 200% per annum on invested capital. Understandably they looked around for other opportunities where those successes might be replicated, so in this rosy light, America seemed to warrant a second look.

Creating a foothold in America required that the aspiring entrepreneur overcome two separate hurdles, each with its own sizeable challenges. First, he had to extract a charter from that imperial power exercizing sovereignty over America, usually England. Applicants exceeded available locales so the government agent's pitted candidates against each other in order to squeeze out the best arrangements for themselves. Second, the entrepreneur had to fashion a viable operation out of local resources which had yet to yield anything near a competitive return. This required redeploying resources in accord with costs which were very different from those in Europe, finding exports which could share in the gains from international trade, and developing local organizations which encouraged participants toward those ends.

English officials passed each serious proposal for a charter through several bureaus seeking ways to raise the government's returns. Understandably the administrators favored charterees whose proposals best promised to maintain the English flag in that part of the world by fashioning viable, enduring settlements. It also helped when they promised to develop exports which paid taxes and complimented England's pattern of foreign trade. Thus aspiring companies discovered that an agent in London was necessary in order to assemble a convincing prospectus and guide it through the bureaucratic channels.

The charter was a necessary, but by no means sufficient step toward success. The organization had to raise an unusually large quantity of capital. Experience in North America soon demonstrated that the optimism of quick returns prompted by India was misplaced. The investors would have to be very patient; indeed, they must accept a substantial risk that their entire commitment could be lost.

Each company also had to develop a team which could get local production going. A strong, creative leader on the site was essential. The governor had to be willing to live in primitive isolation for extended periods, mollifying community concerns while coaxing commercial products into existence. Clearly, the officer had to be granted sufficient discretion to cope with local surprises and yet somehow held accountable for all the assets the shareholders were allowing so far beyond their reach. Companies employed the obvious screening criteria. They hired managers with experience in exploring and colonizing North America. Captain John Smith of Pocahontas fame, for example, was consulted frequently by the organizers of later colonies because accounts of his (overblown) American exploits were widely known. Or, they hired experienced farmers or merchants in England as when John Winthrop, a Puritan landowner, was selected to head the colony of Massachusetts Bay. And they sought to devise incentives such that those personal abilities would be encouraged. Managers, and sometimes important subordinates, were given stock in order to align their efforts with the goals of the chartered company.

Even the best managers would fail, however, unless a suitable organization carried out their objectives. The founders built the best company structures they believed appropriate but usually the crucial factors proved different. Accordingly the products, means of organization, and even the styles of managers often had to be changed once the colony was underway. The Virginia Company, for example, allowed its colonists to elect their own manager upon arrival in America, but instructed them precisely as to the (three) specific missions they were to pursue. Those explicit charges, planting crops, building a fort, and exploring the environs in detail, seemed appropriate to protect the colony and prepare for further undertakings. But they were shaped by experiences with trading outposts elsewhere where such tactics paved the way to profitable trade. The company's intention was to encourage its employees, as they worked well beyond its direct control, to develop specific techniques best for the locality. But mistaken assessments produced misdirected results. A Colonist struggling to avoid starvation will not pay much attention to an income tied to the company's profits. No wonder that the Jamestown settlers soon challenged the company's arrangements and dismissed several managers as they sought remedies. The interests of the Company trustees (far) back in London completely lost out to such pressures.[2]

The Company's initial venture failed by almost anyone's standard. Fewer than 100 of the first 650 colonists survived the first three years and nothing remained of initiatives in local manufacturing. In its second year the Company began revising both its structure and goals. Jamestown had been inspired by the East India Company which dispatched manufactured goods to Asia where they were exchanged for exotic commodities. Beyond maintaining the trading outposts at the distant terminus such an enterprise required only voyages to exchange the goods. In North America, however, no ready supply of indigenous products appeared and Europeans spent decades developing substitutes.

The first reorganization of the Company began the search for arrangements to profit from the (as of yet only partially understood) new environment. Sir Thomas Smythe, a London merchant who had played an important role in establishing the East India Company, took the initiative. His personal leadership departed from the collective effort of 1607. Smythe strengthened the colony's administration in Virginia by making the governor accountable only to the Company in London, thereby reining in the colonists from ventures which did not benefit the colony.

Smythe's expansion of the colony's paid-in capital recognized that creating a viable colony would take longer than expected. He sought more investors by giving each a vote in the company and allowing them to purchase shares in installments. They also were allowed to redeem their shares for land in the colony. This option symbolized the course the venture was assuming. As the company shifted from trade toward an emphasis on developing a local economy ownership of the land became a good vehicle for sharing in the gains. Moreover, it helped the Company extend its scarce capital.

Smythe also nudged the colonists toward developing exports. His first inclination, industrial products, proved unsuitable for Virginia. Labor and capital, typically prime inputs in industrial processes, were expensive in America because most had to be imported. Only techniques which emphasized cheap, local supplies, such as the production of pig iron, ultimately proved suitable.

Thousands of settlers were sent to reinforce Jamestown. Food supplies improved and the Indians retreated out of threatening proximity. The company constructed ironworks, sawmills, and shipyards and sent over artisans skilled in silk and glass. But none of these efforts proved viable and were quickly abandoned when the ultimate solution, tobacco, appeared in 1614.

Smoking had grown more popular since being introduced into Europe several decades previously. Consequently tobacco had become a profitable crop. Thus when a Caribbean and local variety were crossed to yield a plant with desireable characteristics for Jamestown the residents inferred the obvious implications and rushed to share in the profits. This was good news for them--as well as the English government which was concerned to nail down its claim to the region--but, ironically, bad news for the founding Company. The residents abandoned the Company's enterprises in order to clear their own land and plant tobacco.

We now recognize the problem that bankrupted the Jamestown Company--as distinguished from the settlement--is common. Entrepreneurs who do not complete a solution to a problem end up assisting competitors who do. The company's structure did not encourage the proper innovations nor could it capture many of the gains which emerged from the settlement. As is so often the case the key innovations appeared outside the structure and design of the organization.

The success of the neighboring tobacco colony of Maryland beginning in 1630 demonstrated how much useful knowledge had been created in Virginia. It escaped the initial seven years "starving time" by recognizing that they would have to produce most of their own food as well as planting tobacco to pay for imports. Furthermore, Maryland drew immigrants from further afield by eschewing a religious test of residents. A prime motive for founding Maryland was providing a refuge for Catholics, then being persecuted in England. But as other American colonies such as Rhode Island and Pennsylvania, which became havens for dissenters were to discover, not enough of that faith would come to the colony to make it viable. Consequently, the founders had to extend freedom to other religions in order to assure it for themselves. This attracted a motley, but sizeable, increment of settlers chafing at varied restrictions in Europe.[3]

The proprietors of Maryland also improved upon Virginia's administration, especially in the volatile area of relations with the parent English government. Several times the efforts of the Virginia Company had been undercut by changes in royal administrations in London. Maryland's existence was soon similarly threatened. The colony used a dual operation to fend off such threats. Lord Calvert, in London, kept tabs on maneuvers within the Royal government so his brother, Calvin Calvert in Maryland, could apply his full energy to the colony's robust growth.

Many of Maryland's problems with London grew out of a dilemma common to intra-imperial relations. The Imperial government very much wanted to get the colony established. Once a solid claim upon the locality was assured and the colony began participating in imperial trade, however, London was much less concerned as to the specific owner or proprietor. In other words, there was less incentive for the government to uphold its agreement with the founder, especially after the parties to the agreement changed. No wonder proprietors such as Lord Calvert always felt obligated to safeguard their ventures.

The other major undertaking in the formative years of the American colonies after Virginia was Massachusetts Bay Colony. Starting later in 1630 offered both pluses and minuses. While Massachusetts learned from the experience of the earlier colony its economic base differed sufficiently to raise substantial, new problems. By now more was understood about the best means to organize a colony as well as how intense their appetite for capital was. But by 1630 New England had also become encumbered by the claims of previous colonial projects. Such opponents were not so much defeated as outlasted. As long as Massachusetts continued to develop, imposing another proprietor would only jeopardize the Crown's claim to the region. Nevertheless, much like Maryland, Massachusetts had to maintain vigilant representatives back in England protecting its interests.[4]

Even before settlement began, the conceptions underlying Massachusetts Bay's design evolved. At first, it was expected to be a seasonal outpost supplying Europeans who, by the mid 1620's, were frequenting the nearby fishing grounds. Then the Plymouth Colony, south of the proposed site, demonstrated that trade with the Indians could support a settlement year round.

The most likely backers of the colony were the English merchants in overseas trade, sizeable numbers of whom dissented from the Church of England. They were more likely to support the settlement if it served as a refuge for Puritans. But to contribute much toward this end the settlement would have to be much larger, well beyond that which a trading post implied. Thus the promoters began considering agriculture and lumber products as possible economic bases of the settlement. In the end, they opened the way with an advance party of several hundred in 1629 before sending more than a thousand settlers in 17 ships the next year.[5]

Massachusetts hit upon another innovation in colony building which, while seeming minor, even petty at the moment, ultimately advanced them a long way toward their objective. The leaders of the Colony surreptitiously took the charter document with them when they departed England in 1630. Because authority had to be imposed where the directors met, which shifted to Boston, a long, costly reach from London, the Crown's control was reduced considerably. Shifting control to a more favorable base was a tactic Americans would use repeatedly against the British throughout the colonial era.

The Colonists quickly set about administering themselves, creating their own structure complete with the equivalent of governor, senate, house of representatives, judicial system and community officals. In the first two decades a comprehensive legal code was assembled. They felt sufficiently secure to deny the King's directives several times--and that judgment was vindicated. At first, the expanse of the Atlantic was sufficient to stifle the imperial government, and later, the civil was diverted its attention. It was not until 1680--fifty years after the founding of the colony--that a Royal governor was dispatched to Boston! By then the growth of the local economy and the inroads of local practices had reduced most susceptibility to imperial influence.

Shielded from Royal meddling and spurred by religious zeal, something approaching 20,000 immigrants were drawn to Massachusetts in the first twelve years. The arrival of the new residents, along with the assets they brought, fueled a local economic boom. For more than a decade all available hands were kept busy putting up homes, shops and public buildings, clearing fields, roughing out roads, and constructing boats, wharves and fishing equipment. When the influx slowed, however, the economic stimulus also withered and the colony slipped into a recession, complete with falling prices and widespread unemployment. The colonists were compelled to find a permanent base for the local economy. Given their tiny local market this meant, in effect, developing exports in order to pay for imports, thereby buying into the advanced specialization of developed Western Europe. The colonists first attempted to use the resources near at hand: fish, wood products, grain and salted beef. But such commodities couldn't yield much net return because it cost shippers several times their Massachusetts price to deliver them to the nearest markets.[6]

No doubt aspiring exporters in Massachusetts found paying so much to shippers disheartening. But rather than retreat into cynicism they followed the entrepreneurial tactic of asking how this might be turned to their own advantage. They noticed that other American colonists also faced high shipping costs and reasoned that costs might be reduced by consolidating such services. Of course hindsight makes the logic behind the creation of a market such as this appear much more obvious and simple than it was for those who grappled with its formulation. When it's all over it is easy to forget the false starts, plodding frustration and continuing uncertainty that preceeded the success.

Some Boston merchants devised procedures which foreshadowed the creation of an American entrepot, a location where cargoes to and from Europe were exchanged. They gathered up smaller shipments destined for export from along the coast and consolidated them for shipment across the Atlantic. Likewise they imported large orders and parceled them out among the colonies. The savings in freight rates from using larger, more efficient vessels on the longer legs of the trade compensated for the extra handling in Boston. After adding in some of their own innovations the colonists provided this shipping cheaper than anyone. Thus, given the size of freight costs, they developed a service whose potential revenue was the largest the colonists developed, including tobacco. Moreover, it wasn't restricted to the particular combination of soil, climate, and rainfall which limited the production of most American exports, tied as they were to particular natural resources.

Creating new markets is one of entrepreneurs' most important, as well as most demanding and risky, functions. The time, creative energy, and resources required to forge a new market are irreversibly lost if the effort fails. Had the Boston merchants failed to find American customers for the particular goods they purchased in quantity, they would have had to absorb the losses as well as the time spent in prospecting for outlets for the goods.[7]

As in Virginia Massachusetts' experience became a model for nearby colonies. While the Bay colonists were fashioning an economy, sizeable numbers of newcomers moved on, searching for a locale which suited them better. A large fraction of the early immigrants came because they had strong and--by contemporary English standards--radical view of how an ideal society was constituted. Not infrequently this led to bitter disputes about new institutions in Massachusetts and some preferred a chance to fashion their own versions of utopia elsewhere rather than compromise their standard.

The dispersal was not completely driven by moral considerations. The suitable acreage around Boston Harbor quickly filled up. Thus early on there was an incentive to consider cultivable areas beyond. The meadowlands along the lower Connecticut River, for example, attracted farmers whose primary interest was cattle.[8]

Within a few decades after 1630, settlers had established beachheads along the entire New England coast from Connecticut to Maine and inland along those water routes which allowed transportation to the coast. Many of these smaller settlements discovered they were vulnerable to large powers, however. Therefore, they remained receptive to possibilities of bolstering their security of cooperating with other colonies. Plymouth and the settlements in Maine joined Massachusetts. The groups in Rhode Island put aside their differences sufficiently to form a confederation. And the colonists of New Haven, after attempting to retain independence by merging with the adjacent communities on the Connecticut shore, decided that it would be best to join the larger colony of Connecticut after all.[9]

The pressures pushing the smaller settlements toward consolidation probably were similar to those which shaped formative Massachusetts.

Residents of that colony appear to have experimented with numerous possibilities for specialization and exchange, both with other colonies and the rest of the world. Yet both during planning and the early years of settlement underutilized economies of scale in important activities encouraged expansion. Many products such as shoes, hardware, and clothing, were bespoken for consumers because imported goods often proved unsuitable. Even when serviceable, standardized goods were available, high transportation costs tilted Massachusetts' organization toward self sufficiency. Therefore, as immigration expanded the local market producers could specialize further, thus a widening array of local goods and services became cheaper. Production in the colonies not only saved on transportation and handling costs but also matched the product more closely to local requirements. Such increasing returns to scale made themselves felt by raising expected earnings of immigrants and new enterprises in the Colony. Even before settlement began, for example, the founders of Massachusetts Bay sensed that any venture should begin large. Virginia's early efforts, which appeared to have been frittered away in repeated, relatively small commitments, seemed to have been fresh in their minds.[10]

Pressures of this type no doubt encouraged the smaller New England settlements to value the economic integration prompted by unification. But political considerations also were quite important. Both Virginia and Massachusetts had major disputes with the Royal government. Smaller settlements could expect even less leverage and to be correspondingly more vulnerable. The smallest independent settlements, such as those at New Haven, Connecticut, and York, Maine were most vulnerable of all. Leaders of such colonies recognized the threat and considered ways to meet it. Soon the safety afforded by larger principalities became apparent and their entrepreneurial instincts began seeking suitable opportunities for mergers.

NOTES

1. Basic descriptions of this experience can be found in: Charles M. Andrews, The Colonial Period of American History, Vol. 1, The Settlements (New Haven: Yale University Press, 1934), and John E. Pomfret, Founding the American Colonies, 1583-1660 (New York: Harper and Row, 1970). For viewpoints from business history see Ralph E. Hidy, ed., The Formative Era of American Enterprise (Boston: D.C. Heath, 1967) and Gary M. Walton and Ross M. Robertson, History of the American Economy (New York: Harcour, Brace and Jovanovich, 1983).

2. Richard L. Morton, Colonial Virginia, The Tidewater Period Vol. 1, (Chapel Hill: University of North Carolina Press, 1960).

3. Matthew P. Andrews, The Founding of Maryland: Province and State (New York, 1933).

4. Charles M. Andrews, The Fathers of New England: A Chronicle of the Puritan Commonwealths (New Haven: Yale University Press, 1919).

5. A major component of the effort in Massachusetts was directed outside of what is commonly considered to be the economic arena. This raises a common problem, that of defining the appropriate limits of the activity of entrepreneurship. In recent years scholars have experimented with broader definitions. For example see John E. Sawyer's "Entrepreneurial Studies," Business History Review (Winter, 1958) which attacked Schumpeter's definition as being too narrow. Howard Stevenson of Harvard (Harvard Business School Bulletin, Vol. 60, No. 1 (Feb. '84)) simply defined entrepreneurial activity as the creation of value, which would better accomodate the Puritan motives.

6. There is a line of explanation of entrepreneurship which emphasizes the sequence of events leading to entrepreneurial undertakings. In one sense it's an extension of opportunity cost in that events such as losing a job or becoming a refugee reduce the cost of becoming an entrepreneur and thereby encourage the step. See, for example, Albert Shapero, "The Social Dimensions of Entrepreneurs" in C. Kent, D. Sexton, and K. Vesper, eds., Encyclopedia of Entrepreneurship (Englewood Cliffs, NJ: Prentice-Hall, 1982).

7. Mark Casson, The Entrepreneur: An Economic Theory (Totowa, NJ: Barnes and Noble, 1982).

8. Mary Jeanne Anderson Jones, Congregational Commonwealth: Connecticutt, 1636-1662 (Middletown, CT: Wesleyan University Press, 1968).

9. Isabel MacBeath Calder, The New Haven Colony (New Haven: Yale University Press, 1934).

10. Some scholars have made the utilization of economics of scale central to the explanation of growth throughout the North Atlantic area in the pre-industrial period from 1500 to 1800. See Douglas C. North and Robert P. Thomas, The Rise of the Western World (Cambridge: Cambridge University Press, 1973).

ENTREPRENEURIAL IRRUPTION IN THE WORLD SYSTEM: THEORY AND A CASE IN POINT

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This supplements and extends the paper "Nef Revisited" given at the 1985 APEE Meeting (Lincolnshire, IL). That paper examined, albeit briefly, the phenomenon of entrepreneurship in Tudor and Stuart England, from a general systems perspective. This, also briefly, carries on the analysis by looking at Tudor and Stuart entrepreneurship (on the Macro level) within the context on one particular general historical system, the "World-System" of Immanuel Wallerstein. It is suggested that individual expression of the "entrepreneurial spirit" (or, to put it another way, individual entrepreneurship), given proper institutional conditions, lies generally behind major economic development in all ages, and specifically behind the beginnings of "World-System" development in the Sixteenth and Seventeenth centuries. This places the entrepreneur as the motivating force even within the neo-Marxian schema of development.

LEVEL OF PERSONAL MATURITY SEEN AS FUEL FOR ENTREPRENEURIAL SPIRIT

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The business man has been successful in adapting to his natural environment due to the development of communication technology. He has been less successful, however, in adapting to his own potential and extending it into his everyday lifestyle. But as it is true that a revolution is taking place in the incredible pace of communication technology, a no-less stunning revolution is happening in the discovery and application of human potential. Thus the state of maturity training and personal motivation is pushing forward, so that old attitudes and concepts are being abandoned, and in their places exist new, fresh perceptions and theories resulting in practices encompassing maturity, responsibility, and self-supervision, stimulated by the longing for acheivement. This premise is the foundation for the research conducted by the authors for this paper.

THE ENTREPRENEURIAL AND COLLECTIVIST IMPULSES: A PROBLEM IN SOCIAL DYNAMICS

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Why is free enterprise favored in some places but not in others? Why, despite a long and stable tradition of free enterprise in the United States, are there people who do not support such an economic system and who strive to impose political controls on its exercise? Why, despite having one of the most managed economies in modern history, is there a thriving black market economy in the USSR? The paper suggests a broad-based theory of human behavior which might account for these disparate phenomena. The theory focuses on the notion of risk propensity: it argues that people can be placed along a continuum having risk-taking and risk-avoidance at the polar ends. It is then suggested that societies might also be said to evidence the same characteristic. The value in this apporach may be seen in considering the implications of risk-takers who live in a regulated, collectivist society or of risk-avoiders who must get along in an entrepreneurial society. The dysfunctional behavior patterns which result from these incongruities are, in the long run, as harmful to society as they are to the individuals who experience them directly. All evidence, sparse as it is, seems to indicate that the propensity to take risk (or to avoid it) is innate. However it becomes fixed for the individual, it probably does not change much afterward. There may be a tendency toward less risk with age and education but this is highly tentative. Since the notion of risk itself is based on an evaluation of net costs and benefits attached to different alternatives as well as on an estimation of an outcome's probability of occurrence, it follows that risk propensity will be affected by changes in an individual's scale of preferences on the basis of which these evaluations are taken. It also follows, *ceteris paribus* that increasing the quantity of information enables a risk-taker to specify with greater certainty the probability of outcomes. The paper highlights the need for more research on how and when a person's risk propensity is fixed.

THE IMPACT OF BUSINESS EXPERIENCE ON ATTITUDES TOWARD ECONOMIC CONCEPTS

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Public and private schools of business and economics frequently engage in institutional research to understand further the effects of educational training on students but, too often, overlook or underemphasize the impacts of experience in the business world on their recent graduates (Boaz, 1985). The issue addressed in this study is: Does experience in the business world change a person's attitudes toward our economic or enterprise system once he or she has graduated from college? It is postulated that business experience does affect opinions and attitudes, and that these effects are distinguishable from the influences of other factors.

Attitude Model and Measurement Considerations

The attitudes of persons in the business world toward our economic system are a complex function of many personal and experiential factors. Most opinions and attitudes which are held by businessmen are not "all or nothing," or exist or not, but rather are influenced at the margin by changes in business experience and many other factors. Equation (1) expresses a relationship between attitudes (A) toward our system, and business experience (E) and other determinants (O), and the purpose is to estimate the changes in attitudes as responses to additional business experience.

$$(1) \quad A = f(E,O)$$

Opinions and attitudes of businessmen toward our enterprise system is limited here to their dispositions to the profit motive, competition, price controls, government intervention, standard of living, and government ownership of business, and the measurements of their attitudes are achieved through an administered questionnaire which was derived from a Gallop Poll study (Exhibit A). The questionnaire was distributed to university seniors in the business and economic curriculum who serve as a control group and who were enrolled in accounting, business education, business law, economics, finance, management, and marketing courses during the spring of 1985 at the University of Wisconsin-Whitewater, and also was sent to the business and economic alumni for 1975 and 1980 from the same institution.

The opinions and attitudes of the respondents are recorded as ordinal data, and the senior, 1980 alumni, and 1975 alumni groups provide ordinal measurements of business experience. It was considered appropriate to restrict the study initially to students and alumni from one institution because it was possible then to eliminate any institutional effect.

Completed questionnaires were received from 593 seniors in the business and economic curriculum and from 257 alumni; moreover, the responses are regarded as representative of all seniors in that curriculum, as well as of business and economics alumni in 1975 and 1980, and are summarized for inference purposes. Non-parametric tests are used to assess the attitude and opinion effects of changes in business experience because the respondents' attitude toward the business and economics concepts and business experience are measured on an ordinal scale.

Estimated Effects of Experience

The attitudinal responses for each question in Exhibit A were tabulated for seniors, 1980 alumni and 1975 alumni, and chi-square tests were selected to assess any relationships between the attitudes toward the economic concepts and business experience because the data were categorical. Broad impressions about the impacts of changes in business experience on opinions and attitudes are then derived through the examination of the tests for the individual questions.

Exhibit A

OPINIONS AND ATTITUDES TOWARD U.S. BUSINESS AND OUR PRIVATE ENTERPRISE SYSTEM

Directions: Please circle the response that best represents your attitude or opinion to each of the fourteen questions or statements. There is no "right" or "wrong" answer.

1. Some people say that business is too much concerned with profits and not enough with public responsibility. Do you agree or disagree?

    1. Strongly agree
    2. Agree
    3. Undecided or no opinion
    4. Disagree
    5. Strongly disagree

2. Do you believe there is much competition in business today?

    1. Much competition
    2. Some competition
    3. Very little competition
    4. No competition

3. Government should guarantee a job for everyone who is able to work.

    1. Strongly agree
    2. Agree
    3. Undecided or no opinion
    4. Disagree
    5. Strongly disagree

4. Businesses are unable to operate unless they make a profit.

    1. Strongly agree
    2. Agree
    3. Undecided or no opinion
    4. Disagree
    5. Strongly disagree

5. The best way to keep prices at fair levels is through competition.

    1. Strongly agree
    2. Agree
    3. Undecided or no opinion
    4. Disagree
    5. Strongly disagree

THERE IS MUCH DEBATE CONCERNING THE EXTENT TO WHICH THE U.S. GOVERNMENT SHOULD INTERVENE IN THE CONTROL OF BUSINESS IN AMERICA.

6. Do you favor greater government intervention to regulate and control businesses?

    1. Favor
    2. Oppose
    3. No opinion

7. Do you think the government should place stricter controls on business?

   1. Yes
   2. No
   3. No opinion

8. Would you favor or oppose a government policy of breaking up the big companies of the nation into smaller companies?

   1. Favor
   2. Oppose
   3. No opinion

9. Would you favor or oppose having the government bring back wage-price controls?

   1. Favor
   2. Oppose
   3. No opinion

10. Most businesses today make too much profit.

   1. Strongly agree
   2. Agree
   3. Undecided or no opinion
   4. Disagree
   5. Strongly disagree

11. The best way to improve the nation's standard of living is to increase the amount of goods and services produced for every hour of labor.

   1. Strongly agree
   2. Agree
   3. Undecided or no opinion
   4. Disagree
   5. Strongly disagree

12. Would you favor or oppose government ownership of these industries?

   Automobile Industry

   1. Favor
   2. Oppose
   3. No opinion

   Oil Industry

   1. Favor
   2. Oppose
   3. No opinion

   Banking Industry

   1. Favor
   2. Oppose
   3. No opinion

   Telephone Industry

   1. Favor
   2. Oppose
   3. No opinion

13. One way to raise the standard of living in America today is to have businesses reduce the prices of goods.

    1. Strongly agree
    2. Agree
    3. Undecided or no opinion
    4. Disagree
    5. Strongly agree

14. How would you rate the honesty and ethical standards of the people in these 12 different fields?

Building Contractors

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

Engineer

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

Advertising Practitioners

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

Labor Union Leader

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

College Teachers

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

Political Officeholder

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

Journalists

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

Medical Doctor

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

Psychiatrists

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

Farmers

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

Business Executives

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

Lawyers

1. Very high
2. High
3. Average
4. Low
5. Very low
6. No opinion

What the results showed, in general, is that as people gain more and more experience in the world of work, their attitudes change toward the profit motive, competition, price control, government intervention, standard of living, and government ownership of business. In fact, when the alumni and current students were compared, major differences were observed in nearly all categories.

The alumni had much more positive feelings about the need for competition in our system than the current students, and apparently the role of competition and its importance are more clearly understood after years of business experience. When the respondents were asked if government should exercise greater regulation of American business, 18% of the seniors reacted positively, but only 3% of the alumni similarly responded. Also 17% of the seniors and 10% of the alumni indicated that large companies should be broken up, and a greater percentage of seniors expressed the belief that American businesses made too much profit. Finally, the hypothesis that there are attitudinal impacts of increased business experience is generally endorsed throughout the analysis because the responses of the 1980 alumni tend to fall somewhere between the 1975 graduates and the college seniors.

Conclusions

The evidence indicates that an affirmative response is appropriate to the original problem which was posed in this study. Within the scope of the analysis it appears that experience in the business world does affect persons' attitudes toward our economic or enterprise system once they have graduated from college. Beyond the evidence on attitudes and experience, however, is an equally significant outcome. The application of the attitude model clearly demonstrates that primarily differential attitudes must be addressed because opinions and attitudes do not usually exist, or not, but rather are influenced at the margin by additional business experience. It is expected that future, expanded studies will corroborate these impressions.

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IMPROVING STUDENT ATTITUDES TOWARD CAREERS IN SMALL BUSINESS MANAGEMENT

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Introduction

Previous research indicates college graduates were more likely to choose a career in a large business than in a small business (2, 3, p.44, 4). These studies imply the reason college students avoid small business is their tendency to have less favorable attitudes toward small business management as a career. If poor attitudes influence students to avoid careers as small business managers, then the classroom should be an appropriate setting for attempting to change those attitudes.

To determine if the classroom is an appropriate environment to initiate changes in attitudes toward careers in small business management, a pilot study was conducted previously by Brady (1). The study utilized a before and after with control group experiment. The experimental group was exposed to three readings (3, p. 17, 5, 6), in class discussions and professorial comments about the readings, all of which were favorable to small business as a career. The control group received no special treatment and its class was conducted in the normal way. A statistically significant improvement in attitudes occurred among students in the experimental group but not among students in the control group. The conclusion was drawn that attitudes toward a career in small business management can be improved through the introduction of these three readings and accompanying discussion by the professor.

The previous study (1) leaves unanswered whether the specific readings (3, p. 17, 5, 6) and in-class comments made by the professor were unique in some way, thus causing the desired results. If the classroom stimulus was altered, would the same outcome be achieved? Obviously, numerous other stimuli could be conceived for testing. However, lacking the ability to study numerous stimuli simultaneously, a single stimulus that is sufficiently different from the stimulus used in the Brady study should help answer this question. Therefore, the purpose of this study was to determine if more than one kind of classroom stimulus can improve students' attitudes toward a career as a small business manager.

Methodology

A pilot study was employed because of the inability to control experimental conditions in more than one situation. The study is, therefore, exploratory in nature but may be considered as a valid pretest for a larger study which may be conducted at a later date.

The data for the study were obtained from students in two principles of marketing classes. The classes met at different times of the day and days of the week; however, the courses were otherwise identical and the students in each class cannot be considered unique in any way. The demographic profile of each class is summarized in Table 1.

The research design employed a before/after with control group experiment implemented by means of a structured-disguised questionnaire. The questionnaire was designed to elicit data concerning the likelihood of entering specific careers after graduation. A series of five-place semantic differential statements was employed to assess individual attitudes toward the various career areas. As customary for quantifying the dependent variable, all scaled statements were scored 1 to 5 consistent with previous measurement of individual attitudes using single-item measures (7). The t-test for differences between two independent means was employed to evaluate the data.

The questionnaire was administered to both groups during the third week of class. The students were told the purpose of the questionnaire was to determine attitudes toward various careers. Attitudes toward nine different career areas were obtained to disguise the intent of the study and obtain as unbiased results as possible.

Table 1

DEMOGRAPHIC PROFILE OF CONTROL AND EXPERIMENTAL GROUPS

	Control Group	Experimental Group
Sex		
Male	14(50.0)	16(55.2)
Female	14(50.0)	13(44.8)
Major		
Accounting	6(21.4)	5(17.2)
Management	11(39.3)	11(37.9)
Marketing	10(35.7)	13(44.9)
Other	1 (3.6)	0 (0.0)

Table 1 (continued)

Class Standing		
Freshman	0 (0.0)	0 (0.0)
Sophomore	7(25.0)	10(34.5)
Junior	13(46.4)	11(37.9)
Senior	8(28.6)	8(27.6)

(Percentages)

During the course of the term, the control group was exposed to the same three articles utilized in the Brady study (3, p. 17, 5, 6), in-class discussion of the articles, and professorial comments. All aspects of this stimulus were presented in a way which was favorable to small business management as a career. Since the Brady study showed this stimulus improved attitudes, employing it as the control procedure is appropriate. In this way the outcome is known and controllable and the results of the Brady study can be replicated.

The experimental group was given a small business management emphasis throughout the course. The course was taught from a small business management perspective, the advantages of small business were mentioned on a daily basis, and class discussions and examples focused on small business. No readings were used. The experimental group received its stimulus in small doses being reinforced over an extended period of time while the control group received its stimulus in one large dose at one point in time.

The textbook used by both groups didn't discuss small business directly, and both groups were unaware that the content of their courses differed in any way. A course in small business management was not offered while the experiment was being conducted and exposure to small business in other courses was considered minimal.

Two weeks before the end of the term the same questionnaire was readministered to both groups. To minimize the "testing effect," the students were told the maintenance staff had accidentally discarded the original questionnaire and it was being readministered to replace the original. After the second questionnaire was completed, the real purpose of the study was explained to the students.

Findings

If the scaled data are treated as interval data as is customary for attitudinal measures, the t-test can be employed. The results of the t-tests are summarized in Table 2.

Table 2

COMPARISON OF STUDENTS' ATTITUDES TOWARD

A CAREER IN SMALL BUSINESS MANAGEMENT

GROUPS	MEAN	STANDARD DEVIATION	t	p
Control Group/Before Measure	3.25	0.84	0.48	0.633
Experimental Group/Before Measure	3.14	0.92		
Control Group/Before Measure	3.25	0.84	-2.30	0.026
Control Group/After Measure	3.81	0.94		
Experimental Group/Before Measure	3.14	0.92	-3.18	0.003
Experimental Group/After Measure	3.95	0.90		

Source: SPSS

When the control group was compared to the experimental group based on the results of the questionnaire administered during the third week (prior to the implementation of the stimuli), the resulting t-value was not significant at the 0.05 level. A probability of 0.633 indicates that members of the two groups were very likely to hold similar attitudes toward a career in small business management at the beginning of the study.

The control group which was exposed to the same stimulus as in the Brady study produced a t-value which corresponds to a probability of 0.026. This implies that the mean of the after measure is significantly larger than the mean of the before measure. Thus, a significant improvement in attitudes can be assumed to have occurred as a result of the readings and professorial comments. This finding is consistent with the results reported by Brady and was expected.

The t-value obtained for the experimental group was significant at the 0.003 level. This suggests the difference between the means of the before and the after measure is significant. Therefore, the attitudes of students in this group can also be assumed to have improved toward a career in small business management as a result of the course being taught from a small business perspective.

Conclusions and Final Thoughts

The results of the t-tests verify that the classroom is indeed an appropriate environment for improving students' attitudes toward a career in small business management. The findings further suggest two specific conclusions.

1. An in-class stimulus consisting of readings and professorial comments which favors small business management as a career can significantly improve students' attitudes toward this career opportunity.

   Since the control group produced a significant t-value, the results of the Brady study were replicated. This lends additional support to the assertion that attitudes toward a career in small business management can be improved through the introduction of material by a professor that reflects favorably on a small business.

2. More than one type of in-class stimulus can be used to significantly improve students' attitudes toward a career in small business management.

   The significant t-value resulting from the experimental group shows that another type of in-class stimulus can favorably impact attitudes. Thus, specific readings and professorial comments are not unique to changing attitudes. More than one in-class approach can be used to achieve the same result. Apparently, various substantive comments made in the classroom by the professor about the benefits of small business can favorably impact students' attitudes toward a career in small business management.

The results of this study uphold the recommendations presented in the Brady study. Certainly every effort should be made to expose all students to the potential of small business management as a career. Only then can each student be assured the opportunity to decide as unbiasedly as possible on a career in large or small business.

Additional research possibilites become evident from this study. Some of these include the following:

1. Can students' attitudes toward a career in small business management be improved in other ways besides an in-class stimulus? Perhaps other more effective ways exist.

2. What types of in-class stimuli are most effective for improving students' attitudes toward a career in small business management? Perhaps measures can be made to determine

how much attitudes are improved by various stimuli. In this way, the relative worth of the various stimuli can be compared.

3. What level or amount of an in-class stimulus is necessary to produce a change in students' attitudes toward a small business management career? Perhaps the length of exposure or other aspects surrounding the mode of presentation can impact how much attitudes change. Ideally, causal relationships could be identified so that predictions about stimulus level and attitude improvement could be determined.

4. How much of an improvement in attitude is necessary to assure students will consider management in small business unbiasedly with large business as a career? Will some relative improvement, i.e. percentage improvement suffice, or will some absolute value need to be reached to achieve the desired results? Perhaps entry into small business management can be correlated with changes in attitude to help answer this question.

The study of attitude adjustment toward small business management as a career is a burgeoning area. Much needs to be done to understand the mechanism that underlies this attitude formation process. Only a thorough understanding of this process will improve the probability of attracting top quality students to this important segment of our economy. The author recommends that additional research be conducted on this important subject.

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THE EDUCATED ENTREPRENEURS:
AN ERA OF ENTREPRENEURIAL EDUCATION IS BEGINNING

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Can entrepreneurship be taught? Can it be learned? The debate continues unabated in the press, at academic conferences, and even meetings of successful practitioners.

The continued dialogue is worthwhile, but the decision has already been made. Entrepreneurship will be taught and students have chosen in large numbers to learn about starting new ventures and other topics associated increasingly with the emerging field of Entrepreneurial Studies.

No one, of course, can state unequivocally at this time that these "educated entrepreneurs" will be better entrepreneurs because they studied entrepreneurship. But no one can make comparable statements about many other accepted disciplines, e.g., marketing, management, finance, economics, etc. Nevertheless, strong indications exist that an "entrepreneurial education" will produce more and better entrepreneurs than were produced in the past. Tomorrow's educated entrepreneurs will know better when, how, and where to start their new ventures, how to better pursue their careers as entrepreneurs, and how to maximize their goals as entrepreneurs . . . not just for themselves but also for the betterment of society.

An Academic Beachhead Is Established

By mid 1985, entrepreneurship has established a secure beachhead as an academic discipline. This beachhead will expand considerably over the next decade. As it expands, Entrepreneurial Studies will experience some basic changes. In fact, the transformation process already has started. It sees new concepts and curricular approaches being tested in the class room that are significant departures from the past. This new pedagogy marks a new era of entrepreneurial education and a purpose of this brief essay is to describe its advent and explain its implications.

Several hundred business schools now offer one or more courses in entrepreneurship. About two dozen business schools offer programs in entrepreneurship (where a "program" is defined as multiple courses and other key resource commitments . . . funded chairs, entrepreneurship centers, outreach projects/courses, special annual events, networking groups, etc.). In addition, at least one business school has made entrepreneurship a required course. Two others offer it to freshman as a substitute for a management elective or as a bootlegged version of an Introduction to Business course.

An equally interesting fact is that entrepreneurship courses are offered not only at business schools, but increasingly at community colleges, junior colleges and engineering schools. Currently, about 50 engineering schools offer entrepreneurship as an elective course. (Vesper, 1984). Finally, I know of at least one university that offers entrepreneurship within its school of arts and sciences. This adoption makes sense. There is much that economists, historians, sociologists, anthropologists, philosophers, technologists, etc. have to offer to a field that is interdisciplinary to its core. It is very possible more schools of liberal arts will follow suit as they combat the shift in enrollments to schools and programs that specialize in "professional education."

The Beachhead Will Expand

But even if the liberal arts adoption of entrepreneurship doesn't occur, the entrepreneurship beachhead will expand into an established and, ultimately, accepted field of academic inquiry. Basic socioeconomic forces will propel this expansion. They will dispel any thoughts that entrepreneurship is a fad, either as a growing career preference nationally or, at the college level, as an academic area.

At the national level, some fundamental changes are fostering a long term preference for starting, operating, and harvesting new ventures.

These include:

1. The institutionalization of the two income family.
2. The growing recognition that larger organizations do not fulfill basic needs for autonomy and security.
3. The shift in women's roles in economic life along with a parallel shift in the belief that women can be entrepreneurs . . . to the point that the current growth in new ventures created by women is considerably higher than the rate of new ventures created by men.
4. A recognition by policy makers that smaller new ventures are critical producers of new jobs, exports and innovations. (Birch)
5. A desire by local government officials to avoid falling hostage to large corporations that become a city or town's dominant employer.
6. A growing appreciation that the risks of venture failure have been grossly overstated and that entrepreneuring is not just the province of a few superstars or celebrity entrepreneurs. (Shapero, Birley, Ronstadt)
7. An understanding that owning your own business still represents one of the few pathways left to the middle and lower classes to build wealth in an ever increasing tax conscious society that all too often penalizes the achiever who works for someone else.
8. A computer and information revolution that is presenting new venture opportunities while often lowering entry costs and other start-up barriers in many industries.
9. The development of programs to study, teach, promote, and accelerate entrepreneurship in many nations around the world, giving credence to the belief that entrepreneurism is an international phenomenon, not just a national one.

Academic Trends and Entrepreneurship

The wheels of academia move slowly, most often too slowly. Nevertheless, once the wheels begin to churn in a particular direction, they do not easily change course. And academia appears to be moving in a very definite direction toward a new era of entrepreneurial education. Specifically, a number of recent events at the academic level suggests that interest in entrepreneurship will continue to grow for some time. These include:

1. A recognition that the short term/low risk focus of the "traditional MBA" type of business education is wrong . . . not only for potential entrepreneurs but potential managers. (See Hayes; Gilder; Behrman; Peters; and Cheit)
2. A recognition or at least acceptance that entrepreneurship is a process that can be learned and hence is teachable. (Drucker, p. 26)
3. A recognition among key academic decision makers (business school deans) at the 1985 American Assembly of Collegiate Schools of Business (AACSB) conference that entrepreneurship is an important educational innovation which should be given serious consideration and, where appropriate, adopted and/or expanded.

4. The attendance of about 100 potential new teachers of entrepreneurship at a special conference on pedagogy run concurrently with the 1985 annual Association of Collegiate Entrepreneurs (ACE) meeting in Dallas.

5. The launching of the Babson/Price Fellows Program this summer, designed to deliver teaching information and skills to successful entrepreneurs who want to teach, along with several "entrepreneurs in residence" programs at other schools which bring effective entrepreneurs into the classroom.

6. The continuing desire among students and alumni for courses and programs in entrepreneurship. Many business and engineering schools still do not have a single course in entrepreneurship. And where single courses exist, students often lobby for more.

7. The development of a growing number of course materials over the last five years which give potential and existing teachers more to teach on the subject. (Ronstadt, 1984; Stevenson, 1985; Timmons, 1985; and Vesper, 1980).

8. A growing awareness among deans and alumni directors that their most generous alumni donors are individuals who have created their own businesses.

9. The development of a growing body of research, most of it appearing over the last five years. (See Ronstadt, Entrepreneurship Bibliography, 1985; also see especially the five volumes of Frontiers of Entrepreneurship Research that contain approximately 250 empirically based research articles).

From Folklore to Systematic Research

This last development is particularly important since the foundations of our knowledge about entrepreneurship will be reformulated by systematic research. Hard facts will be identified, along with useful concepts. This new information will find its way into the classroom, especially since many of the researchers are also entrepreneurship teachers. With time, the questions that ask if entrepreneurship can be taught or should be taught will be placed increasingly by what should be taught and how it should be taught?

In fact, this replacement process has started. New facts and even a few new concepts, drawn from systematic research, are emerging and being married to new insights on pedagogy. The result is movement toward a new era or "new school" of entrepreneurship education. But before examining this new school, it is necessary to understand its roots.

The Old School

The "old school" of entrepreneurship isn't very old. The earliest courses date back to the 1940's. But less than two dozen schools offered entrepreneurship courses by 1970, as distinct from small business courses. Significant growth began, however, in the early 1970's. By 1975, about 100 business schools had started entrepreneurship courses . . . i.e., courses that focused primarily on new enterprise creation. Ten years later the total number of courses had nearly tripled among AACSB schools alone. (Vesper, 1985)

Until recently, the content of these courses was quite similar to the earliest courses in entrepreneurship. And I believe it safe to say that the old school still exists today in many classrooms. Its early pioneers merit our warm regard for their innovative courage. Acceptance by their academic colleagues was weak, at best, and many a career was damaged, even destroyed, because the "new academic kid on the block" was not understood or was perceived as a threat to a system of management education that largely ignored "business" in favor of producing bureaucrats, euphemistically called "middle managers" for the Fortune 5000 and other large organizations. (Shapero, 1982) The fact that most graduates did not go to work for larger organizations or certainly did not spend the majority of their careers with them was simply ignored by most of academia. After all, studying larger, established organizations was at least tolerable by one's academic colleagues, particularly those in nonmanagement disciplines.

It was also easier and more lucrative. Researching larger organizations led to consulting contracts, board positions, funded chairs and other perks that corporate America was ready to fund. Over the years, the result was the evolution of a system of management education with an implicit value system that clearly favored the large organization versus the small, the established entity versus the new, the ongoing business versus the emerging, the follower versus the leader, the steward versus the creator and risk taker.

Those who bucked this value system found the road a rough one. Advocates of entrepreneurship often found themselves vulnerable to attack, not only when they proposed such programs but also when they were being considered for promotion and tenure. When put on the spot, who could prove entrepreneurship was teachable? Who could prove it needed to be taught? Couldn't marketing, business policy, finance, or some other established area handle it? And what, after all, was researchable anyway? From an intellectual and conceptual perspective, the academic pioneers had very little to work with but their experience and faith. But, as Samuel Johnson noted long ago, "they are ill discoverers that think there is no land when they can see nothing but sea."

While "at sea," the early teachers of entrepreneurship took an extreme action oriented approach to the subject. The tone and direction of the old school was decidely "go out and do it now." The business plan served as the academic heart of these courses. The rest of the course's body was composed of experienced visitors who provided interesting stories, practical advice and inspirational motivation.

This approach was entirely appropriate given the academic state of the art prior to the 1980's. But it possessed some serious drawbacks which have become evident with the passing of time and the advent of new information. Looking back, we can now see that the old school suffered from a bad case of schizophrenia. It preached action and avoidance of "analysis paralysis." But its business plan assignment required 75-150 plus hours of analysis and writing. It preached "doing it" versus "thinking about it." But then teachers advised their students not to start a venture right away. "Better to wait. Work for someone else first for about 5-10 years and then start your own business, preferably in your thirties."

Unfortunately, the schizophrenia went deeper. Despite exercises in "venture evaluation," a deep seated belief existed that human traits determined all outcomes. For many instructors (and their guests) this inner belief was distilled further to a single variable. For some it was perseverence, for others it was courage or "guts," or ambiguity tolerance, or creativity, or achievement motivation, etc. And so despite recommendations for first obtaining some experience, the classic advice for finding a venture opportunity ("just look in the yellow pages for something interesting") had nothing to do with relying on experience. After all, human attributes were the *sine qua non* of entrepreneurship. Real entrepreneurs, if they truly had the "right stuff," would make a venture succeed, despite the environment, despite the structure of the concept, despite critical venture factors, despite all.

A New School is Emerging

None of this advice conforms to our current knowledge about the entrepreneurial process. For instance, the best available evidence at this time indicates that many potential and existing entrepreneurs:

1. Do not consider starting their entrepreneurial careers early enough.

2. Do not consider enough different ways to configure a venture, but tend to get locked into a particular venture

concept prematurely and then spend too much time doing a traditional business plan.

3. Do not consider explicitly the possibility and potential desirability of creating additional ventures and harvesting old ones. Instead they develop bad cases of venture myopia.

In addition, we now know that:

1. Many generic kinds of entrepreneurs exist (which means simplistic prescriptions usually based on the experiences or traits of one kind of entrepreneur do not necessarily apply to other entrepreneurs).

2. Entrepreneurs start their initial ventures at vastly different ages and for a variety of different reasons (which translates into a need for comparative knowledge about their distinctive needs and motivations rather than relying on entrepreneurial quizzes that purport to yield "the" entrepreneurial profile).

3. A need exists to create favorable environments for entrepreneuring (which translates into a need to educate non entrepreneurs about the entrepreneurial process).

This new knowledge about entrepreneurship suggests a need for new and better pedagogical approaches. I believe a "new school" of entrepreneurship is emerging to fill this need, one that is more consistent with entrepreneurial reality. Some key differences between the two schools are summarized in Exhibit 1.

The course content and approach of the new school explicitly recognizes and emphasizes these new perspectives of the entrepreneurial process. These new views of entrepreneurship recognize that it is:

1. A career process.

2. A career process where multiple ventures are the rule more than the exception.

3. A career process of new venture creation where many ways exist to configure or alter a new venture concept and that the initial concept is seldom the best one.

4. A career process where time is the scarce factor, not just in terms of the actual start-up and later operations, but in terms of planning and investing new venture opportunities.

Entrepreneurship as a Career Process

Most people, even entrepreneurs, still do not think of entrepreneurship as a career. Nevertheless, the creation and development of one or more new enterprises is a passage, a field of pursuit, a calling, a way of life that fits the basic notion of a career. For some the passage is brief, but for many it represents the bulk of their adult lives.

In either case, one reason for the lack of recognition about the career status of entrepreneurship is that the passage does not start at a, more or less, similar time for those pursuing it. In fact, entrepreneurship is a career process, started at vastly different times by its practitioners.

The educational ramifications of this "career uneveness" and career non recognition are serious. For among our current students, only a minority of all future entrepreneurs will know when they attend college that they will probably pursue entrepreneurship as a major life pursuit. Of those who are considering entrepreneurship while at college:

1. Only a small minority will start right after graduating.
2. Another small minority will wait but anticipate their entrepreneurial careers by explicitly choosing to work for someone else in a position industry which will prepare them for their future venture(s).

Unfortunately, the vast majority that become entrepreneurs will go to work for someone else without anticipating an entrepreneurial career. Evidence now exists that the lion's share of "career facilities" will be within this latter group. (Ronstadt, 1984, 1985).

Major Implications: Single courses are not sufficient if the goal is to educate the majority of all "potential entrepreneurs" about entrepreneurship. Elective entrepreneurship courses reach only a minority of all future entrepreneurs. Unless these courses are required or other required courses are "entrepreneurialized," most future entrepreneurs will not be "educated entrepreneurs."

Some would say "so what" at this juncture. But the hard truth, whether we like it or not, is that those, who for one reason or another are sensitized to the possibility of an entrepreneurial future, who start earlier, or anticipate and prepare for starting, tend not only to become entrepreneurs at higher rates, but also tend to survive longer as entrepreneurs. (Ronstadt, FOER, 1982, 1983, 1984, 1985).

What then is the answer? Assuming required entrepreneurship courses are not politically feasible at most schools, then I believe the next best option is to develop an entrepreneurship program that may contain multiple courses, an entrepreneurship major and/or concentration, plus other program components. The principal reason for a program is that it helps make entrepreneurship more visible and considered by more students as a career possibility.

For example, practicing entrepreneurs who did not take Babson's lone entrepreneurship course (before our program was introduced) were asked why they didn't take the course. A popular response was "I didn't know at the time that such a course was even offered." (Hornaday, FOER, 1985). We need to reach out, to sensitize students that entrepreneurship is a possible option they will face or consider in the future.

Entrepreneurship as a Multiple Venture Process

A growing body of evidence is emerging that indicates entrepreneurship is a process where multiple ventures are the rule more than the exception. An entrepreneurial phenomenon, called the Corridor Principle, exists and is pervasive. It says that most entrepreneurs will see corridors leading to new venture opportunities that they could not see and/or exploit before getting into business. However, some entrepreneurs will not be able to pursue these opportunities, either by substantially modifying their existing venture or staring new ones, because they are trapped by their current business.

Major Implications: Venture analysis should consider the likelihood, even desirability of multiple ventures or major modifications in the initial venture. Just as a managerial career is often a progression of jobs and positions, an entrepreneurial career is usually a progression of ventures or the creation of "new ventures within the existing venture."

Entrepreneurship As a Process of Multiple Concept Configurations

In-depth studies of new venture creation reveal that entrepreneurship is a process which generally allows many configurations of a potential venture. Some configurations represent less risk and greater flexibility to take advantage of the Corridor Principle without reducing potential rewards. Unfortunately, many new entrepreneurs get locked into a particular venture concept/configuration without considering more favorable options. A trade-off also exists between looking at one variation in great detail versus considering a larger number of variations, some of which may be relevant given the fact that ventures rarely follow the course detailed in traditional business plans.

Exhibit 1

THE OLD SCHOOL VERSUS THE NEW SCHOOL OF ENTREPRENEURSHIP

The Old School Said:	The New School Says:
Don't think too much about the venture. Do it.	Successful entrepreneurs are critical thinkers, as well as action oriented.
Find any opportunity. It doesn't matter what it is. Just get out there and do it.	Build and rely on experience, either personal, industry, or technical experience initially. Also assess the need for "entrepreneurial experience."
Wait until you are 35.	Any age can be the right age, but the odds of career continuance favor starting earlier, during the late 20's and the early 30's.
Do a business plan first.	Takes too much time and is not appropriate for most ventures. Do a creative "venture feasibility analysis" and avoid getting locked into your initial concept prematurely.
Focus exclusively on the venture start-up, almost always the initial venture.	Entrepreneurship is a career, composed, more often than not, of multiple ventures. As such, other entrepreneurial issues exist besides getting the doors of the first venture open.
Rely heavily on outside guests and war stories to provide course content.	Classroom guests, particularly entrepreneurs, are the icing on the cake, not the cake itself.
Little or nothing said about ethical assessment. At best, ethics treated as an after thought, and certainly not a core issue of the course.	Ethical assessment is critical for long term success as an entrepreneur and is a central analytic part of the course, rather than an afterthought.
Entrepreneurial success is a function of one necessary and sufficient condition. . .the right human characteristics and traits.	Entrepreneurial success is a function of a viable combination of human, venture, and environmental conditions. It is a function of not only "entrepreneurial know-how" but also "entrepreneurial know-who."

Major Implications: What's needed is a flexible and time efficient planning mechanism, one that fosters creativity rather than detail, one that identifies options rather than a single course of action, one that is a realistic compromise between the twin dangers of under and over analyzing, and yet one that admits the dominance of uncertainty and our likely inability to foretell the future in a traditional business plan. The latter often requires over 150 hours to produce a good product. By contrast, a "venture feasibility plan" requires 30 to 35 hours of work.

Another article describes the content and procedure of a venture feasibility plan. Suffice it to say that the heavy investment in time required by the traditional business plan is inappropriate for most budding and practicing entrepreneurs, whether they are planning their first venture or later ones. The possible exceptions, and they are a small minority, are those planning high growth ventures that require substantial infusions of venture capital. Separate courses should be established for those who need the time to develop a full blown business plan.

Entrepreneurship as a Process with Limited Time for Venture Investigation

The old school of entrepreneurship recognized the importance of time. But it was emphasized in terms of the time it actually took to start and establish a new venture. The new school takes this notion a step further. Entrepreneurship is a process where the scarce factor is still the entrepreneur's time; however, the scarcity impacts directly on opportunity recognition, investigation, and development not only before but after starting the first venture.

Major Implications: Time must be available to search for, identify, and explore new venture corridors. Such activity is needed in most instances to realize entrepreneurial ambitions and to experience at least a longer entrepreneurial career.

Objectives, Course Structure, and Non Structure

Given these observations, what specifically do courses in entrepreneurship need to teach future entrepreneurs? Exhibit 2 lists 14 goals which I believe are particularly important given what we now know about the entrepreneurial process. This list, of course, can be expanded, and should be, given the needs of specific audiences. (For example, a list of goals for non business students would include relevant marketing, management, finance, etc. goals.)

Exhibit 2

Selected Goals of Entrepreneurship Education

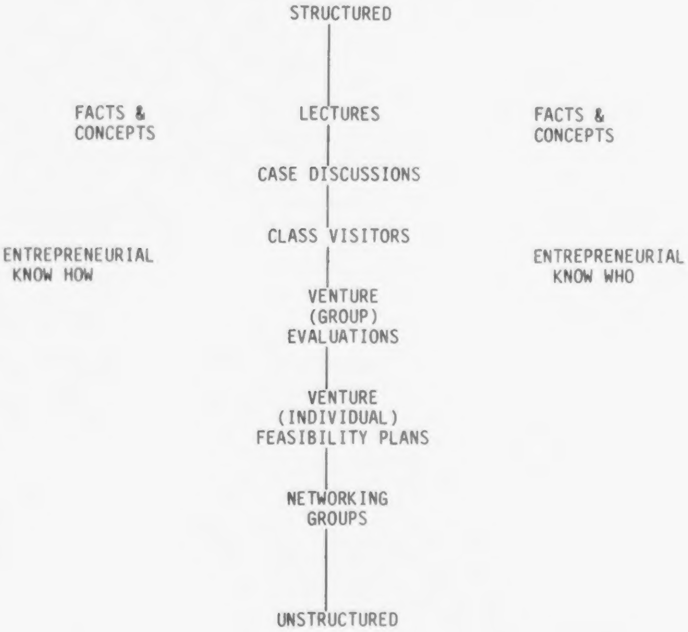
COURSES NEED TO TEACH:

1. Fact versus Myth about Entrepreneurship
2. Reality Testing Skills
3. Creativity Skills
4. Ambiguity Tolerance Skills and Attitudes
5. Opportunity Identification Skills
6. Venture Evaluation Skills
7. Venture Start-up Action Skills
8. Venture Strategy Skills
9. Career Assessment Skills
10. Environmental Assessment Skills
11. Ethical Assessment Skills
12. Deal-making Skills
13. Contacts Networking Skills
14. Harvesting Skills

Given these goals, Exhibit 3 shows the conceptual structure of an entrepreneurship course at either the graduate or undergraduate level. It also represents the structure of an entrepreneurship program which involves multiple courses. The vertical axis shows the course (program) proceeds from being more structured to extremely unstructured . . . to the point that individual initiative ultimately becomes the critical variable shaping projects and outcomes. The rationale for this approach is the uncertain and often unstructured nature of entrepreneurial environments. I think it safe to conclude that the entrepreneurial environment for the vast majority of our graduates will be an extremely unstructured and highly individual experience.

Exhibit 3

CURRICULAR DESIGN FOR
ENTREPRENEURSHIP COURSE(S) AND MODULES


STRUCTURED
FACTS & CONCEPTS
LECTURES
FACTS & CONCEPTS
CASE DISCUSSIONS
CLASS VISITORS
ENTREPRENEURIAL KNOW HOW
ENTREPRENEURIAL KNOW WHO
VENTURE (GROUP) EVALUATIONS
VENTURE (INDIVIDUAL) FEASIBILITY PLANS
NETWORKING GROUPS
UNSTRUCTURED

The horizontal axis in Exhibit 3 shows the course or program moving from "entrepreneurial know how" to "entrepreneurial know who." (Mitton, 1983). The need to understand networking and to make contacts is a critical requisite for long term entrepreneurial success. We know there is a half truth in the dictum: "It's not what you know but who you know." Yet, past courses/programs have not explicitly programmed the development of "know who" skills or fostered networks that last beyond the life of the course.

Contacts are developed through a variety of projects and organizations at Babson that have networking as a primary objective (though it may not always be an explicit or stated goal). Within my course, the Venture Evaluation Project helps students make contacts and observe entrepreneurial know how firsthand. It also gives them an opportunity to apply their "entrepreneurial knowledge," the concepts and evaluative skills they've learned via lecture and case analysis organization called the Entrepreneurial Exchange is fostering contacts and networking by bringing together undergraduate students, graduate students, alumni, and non alumni who have a common interest in "exchanging" information about their entrepreneurial aspirations, pursuits, and services.

From Courses to Major Programs

Many schools have launched entrepreneurship programs in recent years. But a few schools have clearly led the charge. Four of these schools are Babson College, University of Southern California, Baylor University, and Wichita State University. I have designated these four because each school has developed an entrepreneurship program that has excelled along one or more dimensions compared to other programs and each has something important to teach us about developing a program.

For example, USC has, in my opinion, a superior program structure that operates relatively free from their regular business program. They also have developed an extremely strong and integrated teaching team. Babson college has excelled at developing new materials, concepts, and courses generic to Entrepreneurial Studies. Wichita State has led the active development of the entrepreneurship know who side. Its Association of Collegiate Entrepreneurs (ACE) is now a national organization that breeds deal-making and contacts among budding entrepreneurs. Baylor University has developed mechanisms (courses and programs) that give students more and better exposure to the unstructured side of entrepreneurship. Its Venture Assistance Program and its Innovation Evaluation Program extend and improve upon traditional field studies programs or appoaches utilizing Small Business Institutes (which usually do not involve students in the start-up phase of a venture).

While each program has its differences, the people who have developed these four programs (Richard Buskirk at USC, Robert Ronstadt at Babson, Fran Jabara at Wichita State, and Donald Sexton at Baylor) have served together on several panels discussing their programs over the last 15 months. What follows is a distillation of advice about creating an entrepreneurship program.

Critical Factors for Entrepreneurship Programs

A key factor is that nearly all entrepreneurial programs will be composed of elective courses, whether taken at the undergraduate or graduate level. At its most basic level, this fact means entrepreneurship courses must fit into an existing curriculum. Such accommodation is seldom easy to achieve politically or administratively, particularly when talking about a new program and multiple courses. Other professors will have staked out their turf in the competition for the usually limited and scarce "elective" course time of students. The environment, unfortunately, is partially a zero sum one, and will be perceived as such by some.

But who will be hurt or helped is not clear. It is difficult to predict beforehand who will lose students and who will gain them. Such uncertainty inevitably serves as a breeding ground for opposition. It will surface from the flank, or even the rear. These days it is hard to be immediately and openly hostile to entrepreneurship or any acknowledged innovation. It simply is not "open minded." Nevertheless the negative opposition, as opposed to honest constructive criticism, will come.

You must recognize that, in an academic and intellectual battle over entrepreneurship, you have some severe disadvantages. The field is new; it is hard to defend; it has little conceptual substance because it is so young; anyone can kill a new idea; and most of your colleagues will consider themselves knowledgeable even though their entrepreneurship IQs are woefully low. Consequently you will face many self-styled experts who have never run a business or studied the field but will have forceful opinions about:

1. One's ability to teach entrepreneurship. "After all, aren't entrepreneurs born not made." (Actually a wealth of evidence indicates the opposite).

2. The need for a major or concentration. "It won't help students get a job." (Actually, quite the contrary seems to be the case, especially when entrepreneurship is taken as a joint or dual major with some other discipline. Many companies are seeking entrepreneurial types and, if they aren't, then, as one student expressed it, "I really shouldn't be interested in them.")

During the pre-start-up phase of your entrepreneurship program, you must:

1. Gain the total and unqualified support of your Dean, President, or whomever is the acknowledged leader of your school. In short, you must have a Political Champion who will protect you and your program when suddenly puffs of flack appear and their immediate source is unknown.

2. Gain the active involvement of someone (probably an Assistant or Associate Dean) who knows thoroughly the existing inter-relationships between courses, their scheduling, and the impact of various kinds of prerequisites on the ability of students to take your proposed courses. This Administrative Champion will help you avoid many time consuming mistakes as you design your program in the context of an existing curriculum.

3. Avoid the "small business" label. Unfortunately, it is too easy to equate small business, management of smaller enterprises, or small business entrepreneurship with "unimportant business," the "management of potpourri," or "fluff management 101." Like it or not, small business courses have an uneven reputation that includes words like "gut." Those of us in the field know smaller enterprises are important along many dimensions. We recognize there are meaningful differences in strategy and operations based on size. But Entrepreneurial Studies can incorporate these positive aspects without picking up the negative baggage. Remember, size is not the issue. The distinctive focus of Entrepreneurial Studies is enterprise creation, simply because it is the area not being covered by other academic disciplines.

4. Attempt to organize your program as separately as possible from the existing undergraduate and MBA programs, particularly if you are in a university setting. First there is no logical reason to assume "entrepreneurial education" should be made to fit within the existing structure of an undergraduate or graduate school of management.

5. Organize your program in terms of the scheme presented in Exhibit 3 (i.e. structured to unstructured, entrepreneurial know how to entrepreneurial know who) and/or in terms of the venture initiation process. Avoid a "functional approach" that sees courses in entrepreneurial finance, entrepreneurial marketing, etc. Sufficient knowledge does not exist to warrant such courses where good finance and marketing courses already exist or can be developed.

Once your program is launched, you must:

1. Maintain tight control across courses and sections as soon as more than one instructor is involved. Numerous faculty meetings will be needed so you will know the precise topics being covered in each class session. Again, because the field and its courses are not tightly defined, the danger of duplication and redundancy is particularly acute. A close knit team is vital to avoid serious and legitimate student complaints about subject duplication.

2. Maintain a hard line on assigned readings and case assignments. Many "entrepreneurial" students will resist the structured end of the program. Many will want to begin writing business plans immediately. Unfortunately, the road to knowledge is seldom an easy one; students must learn to walk before galloping and you must be the one to exercise constraint.

3. Stimulate awareness of entrepreneurship and your courses by class visits to required courses that occur early in the students program. If possible, develop permanent "entrepreneurial modules" for these courses.

4. Develop outreach programs that bring students together with alumni and non alumni who are entrepreneurs and professionals assisting entrepreneurs. Such associations will foster the know who or networking side of entrepreneurship.

The New Era and The Future

The interplay between research, course development, and teaching is a close one for entrepreneurship. As new concepts emerge from systematic research, case studies, or other in-depth clinical studies, the need to reformulate teaching approaches will become increasingly vital to maintain currency with knowledge about the entrepreneurial process.

Currently, I believe we are entering the early phase of a new era of entrepreneurship education. New knowledge about the process of entrepreneurship is suggesting new pedagogical approaches. Conversely, these new approaches must do a better job conveying or transferring this new knowlege to tomorrow's entrepreneurs.

Transferring this knowledge will require increasingly the development of programs of entrepreneurship, not just individual token courses. Like any new venture, these new programs in Entrepreneurial Studies must be given room to breathe, flexibility of movement in order to develop their educational products, and protection to grow and flower into a healthy maturity. Their success is critical, not just in terms of developing more and better independent entrepreneurs but also in terms of fostering an entrepreneurial spirit, perspective, and approach among managers and employees that will rekindle our desire to excel, to be the best, and to innovate and pioneer. While it may be possible "to manage our way to economic decline," the opportunity exists for us to entrepreneur our way to economic and social prosperity.

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THE ENTREPRENEURIAL ASSESSMENT CENTER: A CONTEMPORARY TOOL FOR ENTREPRENEURSHIP ENHANCEMENT

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Introduction

It is widely accepted in the American business community that entrepreneurial ability is the key to improved productivity and to more effective competition in the world marketplace (Stevenson & Gumpert, 1985). The vigor of entrepreneurship has gone through cycles in American business and is currently experiencing a growth period with greater media coverage than ever before (Wall Street Journal, 1985).

Small business management is one major component of the entrepreneurship domain. Other components of interest are corporate entrepreneurship (Pinchott, 1985); Emerging Businesses (Cohen, 1984); and Public Sector Entrepreneurship (Ramamurti, 1985). While these latter issues are important, the small business management component is the one with the longest history and has received the most attention from scholars and writers. Within this component, entrepreneurship and entrepreneurs are continually promoted as keys to the future development of our free entrepreneurial system. In doing this, many programs have sought to train or educate potential entrepreneurs in a variety of ways.

While there are numerous high quality entrepreneurial educational programs available nationwide, education can take place at a number of levels. The seminar/workshop addressing specific business problems is the most common type. These workshops, however, are often quite generic and are not directed at specific problems of specific entrepreneurs.

An alternative approach to education would be to first examine the entrepreneur and then make specific recommendations as to how weaknesses in each individual could be corrected. The target of this education can be put into two categories. The first of these is the specific business skills. These are the skills typically addressed by the seminars and workshops identified earlier.

The second type of skill is somewhat harder to define. In fact, skill may not be the appropriate term to describe these ideas. Numerous articles have been written which attempt to define a set of characteristics which are common to successful entrepreneurs. Gartner (1985) pointed out the attempt to develop a psychological profile of the entrepreneur and measure such characteristics through the works of DeCarlo and Lyons (1979), Hornaday and Aboud (1971), McClelland (1961), McClelland and Winter (1969), Schwartz (1976), Brockhaus (1980), Litzinger (1965), Schrage (1965), and Ronstadt (1984). Some examples of repeated characteristics in the research are (1) need for achievement, (2) locus of control, and (3) risk-taking propensity. Gartner's (1985) work also points out individual characteristics that have been studied such as:

Job Satisfaction (Collins & Moore, 1970; Komives, 1972)

Previous Work Experience (Cooper, 1970; Lamont, 1972)

Entrepreneurial Parents (Collins & Moore 1970; Schrier, 1975; Shapero, 1972)

Age (Komives, 1972; Liles, 1974; Thorne & Ball, 1981)

Education (Brockhaus & Nord, 1979; Collins & Moore, 1964; Roberts, 1969)

These characteristics are qualitatively different than the business skills mentioned earlier. While both are important, the more tangible business skills are the ones which have received the bulk of the assessment and training attention. The reasons for this situation are undoubtedly connected to the fact that the specific business skills are easier to measure and train. However, there is currently no systematic strategy for assessing the less tangible entrepreneurial characteristics as suggested by these authors.

The Entrepreneurial Assessment Center

The objective of this paper is to analyze the development of an Entrepreneurial Assessment Center (EAC). The EAC would be directed at the less tangible skills mentioned earlier and should be able to make several contributions to the small business sector of the economy.

The primary purpose of any assessment center is to measure the management and administrative skills of center participants. Managerial assessment centers have been used extensively by large corporations with consistent positive results (Byham, 1970). While the specifics of assessment centers are described later in this paper, it is important to note at this point that the assessment center model has several parts. First, the skills and abilities required for a job are defined using job analyses. Once these are identified, a set of measurement devices is selected or created to assess these skills. A team of raters is then trained to systematically administer these devices and rate candidates on their performances under controlled conditions. A number of studies over the years have confirmed the predictive validity of assessment centers in identifying managers with potential for success. (Bray and Grant 1966, Bray 1966, Alexander 1979, Hinrichs 1978, among others).

The outcome of the process is a detailed report summarizing an individual's strengths and weaknesses. There are a number of ways that this process could be applied. For example, prospective entrepreneurs could use this information as part of a self-analysis to identify specific areas for improvement.

Another application would be for organizations which must screen prospective small business managers. This particular activity has become more important because of a number of new entrepreneurial training programs which have been introduced recently. One model for these programs is to recruit unemployed individuals and provide them with entrepreneurial training rather than traditional job skills training such as "welding." The advantage of this type of self-employment training is that it offers people the opportunity to create their own jobs rather than depend on the industrial system to create a job to match their skill.

One weakness of these entrepreneurial development approaches has been the selection of candidates for training (Kuratko, 1985). The EAC can serve as an initial screening device for candidates as well as serving as a guideline for training of those selected.

Another potential application is for bank loan officers. In cases where a person seeking a loan does not have a track record in business, or some other doubts exist about the applicant's ability, the EAC report can be used to help in decision making.

One final side benefit of EAC would be on a theoretical level. Information gathered during the development process can be used in formulating a comprehensive empirically based model of the entrepreneur. While initially the model will not have direct applications, it could eventually not only enhance our understanding of entrepreneurship, but also foster its growth.

Corporate Assessment Centers

The assessment center had traditionally been a tool for determining the skill levels of individuals who are being considered for promotions in large organizations. The assessment center creates a simulated work situation to which the candidate must respond. These responses are then observed and rated by trained observers. The effectiveness of the assessment center has been evaluated in a number of studies which for the most part, support its ability to predict future job success.

It is important to highlight the major issues and controversies associated with assessment centers and relate those to their application to entrepreneurial assessment. The following is a list of points which will be examined:

(1) Format and content of assessment centers

(2) Assessor selection and training

(3) Center reliability and validity

(4) Candidate selection

While many of these specific topics have received considerable research attention, others have been dealt with on only a conceptual issue.

(1) Assessment Center Format and Content. There is no best way to structure an assessment center. The specific objectives of the center will be the guiding factor in establishing the parameters for the structure, content and administration of any given center.

The primary feature of assessment centers which distinguishes them from other techniques is the systematic use of multiple methods of assessment. Some typical activities that might be found in an assessment center are: the in-basket exercises, leaderless group discussions, problem solving cases, interviews and tests, that are both objective and projective. The choice of particular activities, depends on the dimension to be assessed, but there is considerable latitude within each so that they can be focused on the dimensions of interest.

Candidates are generally assessed in groups which can range in number from six to twelve with the ratee-to-rater ratio ranging from three to one and one to one. An assessment center may run for one to three days.

The selection of a specific combination of these factors depends upon center objectives. In many organizations the higher the level of management the longer the center experience so that more data can be gathered. For the assessment of entrepreneurs it is anticipated that a 1-1½ day experience will be sufficient. However, this will be determined only after careful analysis of the dimensions to be assessed.

The determination of the rater to ratee ratio will also be a function of the types and complexity of activities used. Cost is a direct function of these factors and must, of course, be considered in any determination of the final form of the assessment center.

(2) Assessor Selection and Training. The assessor in the center is responsible for observing and evaluating the behavior exhibited by candidates. Observation is performed by a team of assessors who then combine their individual evaluations to determine a candidate's overall evaluation. Richards and Jaffee (1972) have demonstrated the importance of training raters for an assessment center. In their study, interrater reliabilities for observation increased substantially when raters were trained. Training entails teaching observers how to recognize and code the specific behaviors elicited by the exercises used.

In most organizations, the assessment team is a mixture of behavioral scientists and practicing managers. Using managers has the advantage of bringing operational knowledge to the assessment center while at the same time training managers in a skill that can be used back on the job.

The assessor team for an entrepreneurial assessment team would ideally be made up of behavioral scientists and individuals knowledgeable in entrepreneurship and small business management.

(3) Reliability and Validity. Reliability in the assessment center is defined as the extent to which independent raters rate the same candidate in the same way. This interrater reliability has been demonstrated in several studies (Finkly, 1976, Schmitt, 1977 and Sackett and Hakel 1979). The convincing evidence provided by these studies confirms the assumption of assessment center theory that the traditional weakness of individual evaluation can be offset by multiple observers operating in a relatively structured environment.

The validity of assessment centers has also received considerable support. Various criteria have been used and in each instance generally strong positive correlations have been found between assessment centers ratings and these criteria. For example, assessment center ratings have been found to be related to job performance (Finkle 1976, Howard 1974) and also to future promotions (Bray and Campbell 1968; Hinrichs, 1978; Mitchel, 1975).

In contrasting the assessment center with traditional selection techniques, Cascio and Silby (1979) found that under many circumstances the assessment center offered substantial financial advantage. In their study they compared the evaluation from assessment centers to traditional selection methods and found the assessment center superior from a cost perspective when selection ratio, validity levels and variability in performance variables were weighed.

The EAC presents unique criteria against which to judge validity. If the EAC is used to select candidates for entrepreneurial training, then training success can become an appropriate index. If the assessment is used for making a loan decision, then the criterion for the EAC becomes the probability for actual success in business.

Methodology in Developing the EAC

The type of project takes place in three stages. The first stage is concerned with identifying the behavioral dimensions appropriate for the EAC. The second stage entails the development and pilot testing of measurement devices to be used in the center. This stage also includes the training of raters who would conduct the actual assessments. The last stage consists of running the assessment center and conducting a validity study to test its effectiveness.

Identifying Dimensions. The first step in any assessment center is to decide exactly what is going to be measured. This generally involves conducting a thorough organizational analysis to identify those key behaviors that are required for successful job performance. Unfortunately, when dealing with entrepreneurial behaviors there is no single organization on which an analysis can be conducted. The best strategy appears then to be to survey a large number of small business owners and managers to determine which behaviors or skills are seen as most important.

This phase of the project has already begun. A sample of 63 small business owners and managers was surveyed. They represented businesses in several categories including retail merchandise, service, construction and manufacturing. A list of 33 characteristics with their definitions was constructed and scaled from 1 (essential) through 3 (desirable) to 5 (unessential).

The characteristics included in this list were generated from a number of sources. The literature on entrepreneurship was examined to identify characteristics which have been viewed as important by researchers and scholars in the field. The literature on assessment centers was also reviewed to identify the traits typically examined in assessment centers. The criteria for including an item were that the characteristics had to be relevant to small business activities and second, that the item was a trait that could actually be measured in an assessment center.

Each businessperson was interviewed personally by a student research assistant and responses were recorded on a coding sheet.

In addition to small business owners and managers a group of 26 bank loan officers was also surveyed. These individuals are charged with the responsibility of assessing the ability of an individual to be successful in a business venture for which a bank loan is sought. They were asked to rate the same set of characteristics described earlier. Table 1 shows the summary rankings in this study.

As reported by Montagno and Kuratko (1986) there were a number of similarities as well as differences between the rankings of the two subgroups. While these results have significance at a theoretical level, they also have practical implications for the development of dimensions in the EAC.

The dimensions identified as important by both groups are, at this point, the foundation dimensions in initiating this concept.

It should be noted that the types of skills and abilities of interest here are not technical abilities which are comparatively easy to measure. The real targets of the assessment center are those traits which are more subjective and are typically difficult to both define and measure.

Therefore, the research on this aspect of identifying dimensions is now being expended to well over 200 small business owners in order to obtain more substantial information.

Measuring Instruments. Once a final set of assessment dimensions have been established a specific set of tools to rate these dimensions could be developed. It would not, at this time, be possible to specify the exact nature of these tools, but it is anticipated that most would be similar in structure to those in current use in traditional assessment centers. Among those, would be the in-basket exercise, leaderless group discussions, structured interviews, projective personality tests, and business games.

In order for any of these particular activities to be effective, several steps may be taken. First, the specific behavior must be elicited by the activity. For example, if decision making is to be rated the exercise must require the ratee to make decisions about a specific stimuli in order to complete the exercise. Next, the potential responses of the ratee must be observable and scalable. This means that the rater must be able to discern that the candidate has acted and the ratee must be able to rate that action on a scale. In most cases, this will require some kind of oral or written response by the candidate followed by a determination by the rater that this response is good or bad. Rating scales can take many forms, but will generally be a multipoint graphic rating scale using five, seven, or ten point scales.

Since the process of scaling depends on the specific situation, it only can be determined after the final dimensions are chosen.

Rater training is a key element in this development phase. Raters must clearly understand the behavioral clues associated with each dimension and how these behaviors related to the established quality scale. A part of rater training should include attendance at a professionally conducted seminar on behavioral assessments by at least two members of the EAC teams.

The next step should be running a pilot test of the materials to determine if the exercises actually discriminate among the behaviors of ratees and to assess the rating reliability and accuracy of raters.

Evaluation of the EAC. The real test of the value of the EAC would be its ability to predict whether or not individuals will be successful entrepreneurs. There would be two basic approaches to judging the success of the EAC. The first and fastest is a content validity approach. This entails obtaining judgements from knowledgeable experts that the dimensions assessed are relevant and the techniques used for assessment appear reasonable. The second is a criterion related validity approach which is more time consuming, but uses actual field performance data to judge EAC effectiveness.

The basic process would be to rate a sample of current small business owners and managers on the EAC dimensions and then compare those ratings with actual business success. For the EAC to be valid it should discriminate those who are successful from those less successful. The actual measures of success used will have to be determined for each individual business.

Once the validity of the EAC has been established, it can be used to identify those who have the greatest potential for success in a small business venture.

The long-term effectiveness of the EAC would be determined by examining the eventual success of individuals who are assessed in the EAC and then start their own business. It is the success of these individuals that in the final analysis, will support the EAC as an effective tool.

Conclusion

The purpose of this paper has been to examine the development of an Entrepreneurial Assessment Center (EAC). The objective of an EAC would be to assess the managerial skills as well as the entrepreneurial abilities of prospective entrepreneurs. This information could be valuable on several levels. First, it could be used to screen individuals seeking training through programs funded by the federal government. It could also be used by individuals to custom design education programs for themselves. Finally, it could be used by bankers and venture capitalists to determine if an entrepreneur without a history of success might be a good risk.

Table 1

Ranks of All Items For Small Business Owners/Managers (SBO/M) and Bankers

Item	SBO/M[a] Rank	Bankers[b] Rank
Oral Communication	1	3
Listening	2	9
Self-Motivation	3	3
Determination	4	2
Confidence	5	14
Problem Analysis	6	1
Initiative	7	10
Caring	8	23
Planning	9	3
Insight	10	19
Judgement	11	7
Motivation of Others	12	11
Leadership	13	3
Organizing	14	7
Encouragement	15	23
Goal Directed	16	11
Management Control	17	19
Decisiveness	18	14
Innovation	19	25
Structuring	20	22
Need for Feedback	21	23
Optimism	22	26
Staffing	23	16
Achievement Orientation	24	16
Flexibility	25	21
Interpersonal Insights	26	29
Quantitative Analytic Ability	27	28
Independence	29	31
Delegation	28	18
Conceptualization	30	29
Risk Taking	31	33
Organizational Sensitivity	32	11
Oral Presentation	33	32

[a] n=63

[b] n=26

(Source: Montagno, R. V. and D. F. Kuratko. "Perceptions of Entrepreneurial Success Characteristics," American Journal of Small Business, forthcoming, 1986).

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CORPORATE ENTREPRENEURSHIP
THE NEW EDUCATIONAL CHALLENGE

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American business is currently facing unprecedented economic challenges from foreign companies headquartered in a variety of countries, most notably Japan. Historically, competition has been the hallmark of American enterprise, and the corresponding response by American companies has increased the efficiency of our economy and raised our standard of living. This new wave of competition offers the same potential if business leaders accept these economic challenges rather than trying to thwart them by supporting protectionist trade legislation.

Today's business environment is one of global economic interdependence effectively precluding any government from influencing its domestic economy without jeopardizing the success of its own firms in other countries. American companies must chart their separate courses through this competitive maze without expecting any legislative assistance. It is imperative that American firms explore new approaches to meet these challenges lest they lose their markets to foreign companies.

The question now is how American business can react positively to this new age of competition. One response currently being promoted is incorporating entrepreneurship into large corporations. This renewed interest in entrepreneurship is evident in the popular management literature beginning with the publication in 1982 of In Search of Excellence by Thomas Peters and Robert Waterman and Megatrends by John Nasbitt. These books have been followed by The Change Masters by Rosabeth Kanter, Intrapreneurship by Gifford Pinchot, Innovation and Entrepreneurship by Peter Drucker, A Passion for Excellence by Thomas Peters and Nancy Austin, and Re-inventing the Corporation by John Nasbitt and Patricia Aburdene. These books document the challenges facing American firms today and offer a variety of prescriptions to meet them. The common thread running through each is the importance placed on fostering innovation in large organizations. This is an interesting perspective because no one has suggested that dissolving large corporations is the best way to increase the competitiveness of American business. As a matter of fact, Drucker has called ours the "employee society," reflecting the general consensus that large organizations are an economic necessity. Their economies of scale, division of labor, and cost advantages are becoming evident in markets of all types. For example, hospitals are branching out into neighborhoods to offer routine medical care. Franchised firms like McDonald's and Midas Muffler have firmly established themselves in markets once dominated by local businesses. The challenge is how to make larger organizations more responsive to changes in the marketplace.

In this paper we focus on the most important characteristic of entrepreneurship, innovation, and discuss how we as management educators can instill this attribute into our students. Entrepreneurship does not simply mean starting a new business but starting a business that is new. If entrepreneurship is to be widely applied in business, then management educators need to discuss its merits and limitations. This is the function of management education in its partnership with business. We expend a lot of energy expounding the quantitative tools and other management techniques which help run a large company. Now we must apply the same energy to educating our students on how to make a company large. Our challenge is to develop within our students a creative problem-solving capability to better cope with the increasingly complex and uncertain environment facing American business today.

OWENSBORO ENTREPRENEURS PROJECT

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Owensboro Entrepreneurs is a series of four one-half hour television interviews produced for a local commercial TV station. Each program featured a major local entrepreneur.

The purpose of "Owensboro Entrepreneurs" was to reemphasize the role of entrepreneurs in a private enterprise economy in a way that would make the concept more relevant to people in Owensboro and the surrounding communities. Entrepreneurs perform a vital role in a private enterprise economy. Yet, standard coverage of this concept in undergraduate economics and management classes tends to be minimal at the best. Furthermore, awareness on the part of the general public also tends to be lacking.

On each of the TV programs a prominent business-person from the Owensboro community was interviewed. By interviewing individuals who are well-known in Owensboro, it was felt that the idea of entrepreneurship would be more meaningful and interesting to our viewers. At this stage of their careers, each of our participants is perceived as a successful businessperson but the public might not have been aware that they were all outstanding entrepreneurs. Each had recognized a need in the Owensboro area and started a business, at some personal risk, to meet that need. By discussing how these individuals achieved the status they have today, the viewers were exposed to what an entrepreneur is, that opportunities still exist today in our economy both on the local and national level, and how the private enterprise system works.

The "Owensboro Entrepreneur" programs make the concept of an entrepreneur "come alive" in the classroom. (Most textbooks use historical examples that have little relevance to Owensboro students.) Our students seem to be very taken with the fact that they personally know of an entrepreneur and that entrepreneurs can be found in their own community. The opportunity to relate the rather abstract concept of an entrepreneur with the concrete examples presented in the tapes helps to increase their interest in and understanding of entrepreneurship.

EXPORTERS' PROFILES AND EXPORT CONSTRAINTS: A STUDY OF SMALL AND MEDIUM SIZED FIRMS IN MINNESOTA

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The current U.S. trade deficit is at a record high at $148 billion (first quarter 1986) compared to $5.6 billion in 1976.[1] A substantial increase in sales is required to reduce this trade deficit. In addition, each $15,000 increase in exports creates one new job.

It is felt that small to medium sized firms can contribute in the reduction of trade deficit by exporting. According to the U.S. Department of Commerce, 60% of all U.S. exporters are small, having less than 100 employees. Small businesses are, therefore, important and can be competitive in international markets. Although a large number of small firms exports, almost 80% of the total value of exports is accounted for by large multinational corporations.

More and more local and state governments are recognizing the importance of exports and are interested in developing policies to encourage exports among smaller firms. In Minnesota, the state government is actively formulating policies to increase exports and to encourage small to medium sized firms to export.[2]

The purpose of this study is to determine the company profiles[3] of successful exporting firms in Minnesota. By determining those characteristics, it will help in forecasting a firm's potential success in exporting. It will also help in identifying firms for export promotion and export awareness programs. The second part of the study aims to determine the export constraints perceived by the non-exporting firms. The information on the factors that affect a firm's decision to export or not to export will help in the development of important export incentives, export assistance programs, and export policy formulation in the local, state and federal level of government.

NOTES

1. Ernest W. Ogram, Jr., "Exporters and Nonexporters: A Profile of Small Manufacturing Firms in Georgia," Export Management, eds. M. Czinkota and G. Tesar, 1982.

2. Examples of government export incentives were the creation of the Minnesota Trade Office, development of the Minnesota World Trade Center and the creation of Export Loan Guarantee program through the Minnesota Trade Office.

3. Other studies of this nature have been conducted by Kothari and Austin, Ogram, Jr., Tesar and Tarleton, and Roy and Simpson.

FINANCIAL ANALYSIS MADE EASY: USING FINANCIAL SPREADSHEETS IN ENTREPRENEURSHIP AND NEW VENTURE COURSES

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With the advent of financial spreadsheet software, such as LOTUS 1-2-3, prospective entrepreneurs and students enrolled in entrepreneurship courses are enabled to get a relatively quick handle on a most difficult and long-standing problem: financial management. Studies of small business failures have shown that an examination of what records were available revealed signals of impending disaster long before the actual collapse of the enterprise. Had these owners understood the meaning of these records and reports or sought expert advice, it seems evident that many failures and associated economic waste and personal hardships could have been prevented. This assumes, of course, that there was a market for the product or service offered and that the business owner was sufficiently able as an administrator and manager.

Feasibility studies of proposed ventures require rather comprehensive financial analyses and we insist that our students make appropriate projections of cash flow, income statements and balance sheets for at least two years. In the past these student studies largely were rather elementary due to the time required and the difficulty of making necessary calculations. Consequently few scenarios were examined in detail.

Now that financial spreadsheet software is so readily available and affordable, nearly all small businesses can take advantage of the power of such programs to better manage the financial aspect of the firms. Accordingly, we have developed some simplified and basic instructions in the use of LOTUS 1-2-3.

In essence the steps are these:

1. Students are provided with a sample P&L statement and guided step-by-step with each keyboard entry needed to replicate this statement on the screen and how to make simple mathematical formulas for addition, subtraction, division and multiplication.

2. Students are then guided through a series of simple calculations on determining percent relationships of expenses to sales and interest rates.

3. Next follow the steps necessary to project the P&L to subsequent years using varied percent changes for anticipated sales and related expenses based on different scenarios.

4. From these data, students are shown how quick and easy it is--once the basic format and formulas have been developed--to see immediately the P&L result of changing a variable such as interest rate or loan amount.

5. Based on the same approach, students are encouraged to move on to develop cash flow and balance sheets and make a variety of projections.

SCHOOL-BASED BUSINESSES IN GEORGIA

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Recent studies show that the majority of economic growth of an average American community resulted from the creation and expansion of locally owned and operated enterprises. For future economic development, especially in rural areas, small-scale entrepreneurship may be a better model than industrial recruitment programs. In order to do this, however, new programs and policies that stress entrepreneurship are necessary. One such program in Georgia has attempted to broaden the education of high school students to make them more aware of the role of small business in the U.S. economy and the economic possibilities offered by entrepreneurship.

The goals of school-based businesses are to (1) create a profit-making enterprise that meets the unfilled needs of the community; (2) provide employment opportunities to students; (3) generate or attract income-producing opportunities to the community; (4) provide a vehicle for entrepreneurial training and academic development; and (5) have a positive impact on curriculum and other aspects of the educational system.

The school-based businesses that have been started in Georgia at the secondary level are varied. A day-care center, a feeder pig operation, a construction company, a quick print shop, a T-shirt printing shop, and a sheep raising operation have all been opened. A tourist train, a tourist retail shop, and a goat dairy operation are in various stages of planning. At the university level, an export trading company has recently been incorporated.

The success level of the businesses has been as varied as the types of businesses opened. The day-care center has experienced the greatest success, meeting all the goals of a school-based business. The feeder pig operation also met the goals but has experienced some problems due to sickness in the herd and sagging farm commodity prices. The quick print shop and the sheep raising operation were initially successful but, after a change in leadership, both have faltered. It is too early to judge whether the tourist train, tourist retail shop, the goat dairy, or export trading company will be successful.

Some of the difficulties inherent in the school-based business concept are that (1) achieving success is directly tied to the leadership ability of the individuals responsible for the project; (2) gaining community support is difficult unless the school-based business avoids competing with local businesses; (3) gaining the support of school administrators is crucial to the success of the project but difficult to achieve because of their unfamiliarity with the concept; (4) funding for the business at the level necessary to achieve success is difficult to obtain; and (5) tailoring each school-based business to local needs makes the concept more difficult and slower to implement. Despite the problems noted, the concept of school-based enterprises holds promise as a model that provides academic experience while promoting entrepreneurship, self-employment, and small business development.

ADAM SMITH'S "THEORY" OF INVESTMENT IN HUMAN CAPITAL

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Adam Smith's "theory" of investment in human capital lends credence to the idea that increases in the acquired abilities of people throughout the world, and advances in useful knowledge, hold an important key to future economic well-being. Smith seemed to recognize that natural resources, physical capital, and raw labor are not sufficient to develop a highly productive economy. Although Adam Smith did not define "human capital," he did include useful abilities of the inhabitants of a country as part of capital. He said the skill of a man could be regarded as a machine that has a genuine cost and returns a profit. Even in 1776, he saw a need for a wide array of human skills as essential. *Wealth of Nations* recognizes human capital as a worthwhile private investment, as essential for the efficient allocation of resources, and a vital public good. *Wealth of Nations*, with its emphasis on the importance of labour and the self-interest of the individual, at least to some extent, explains the economic success today of economies without a strong natural resource base or a large national territory such as Hong Kong and Singapore, and the economic miracles of countries like Denmark, Switzerland, and Japan.

Several of Adam Smith's most well-known statements infer that he had a strong commitment to the improvement of labour or human capital. Certainly the following quotations speak of the need for each individual to have the basic literacy to function intelligently within their society. "But it is only for the sake of profit that any man employs his capital in support of industry; and he will always, therefore, endeavor to employ it in the support of that industry of which the produce is likely to be of the greatest value, or to exchange for the greatest quantity either of money or of other goods . . . he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it."[1] Or put another way: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."[2] If people are motivated by rational self-interest to employ the resources under their control, where ever they can get the highest possible price, if allowing this "natural liberty" leads each individual to work for the good of other persons, it seems rational that investment in human capital would benefit society. It is evident that resources under the conditions of an intelligent and an informed public would be much more efficiently allocated than under conditions of ignorance and lack of information. If the public maximizes benefits from individual labourers seeking their own self-interest, if individuals maximize their benefits by being able to supply the highest quality labour relative to the intensity of consumer demands, then again investment in human capital would enhance the well being of society.

Cost-benefit analysis by the World Bank shows that investing in human capital has had relatively high rates of return. They now use a premise that: "No machine can be operated effectively or agriculture project executed properly unless it is appropriately staffed . . . human capital is created and the quality of human input in production is significantly improved by spending on education."[3] The World Bank has had over 224 educational projects throughout the world since they made their first educational loan in 1963. Studies from their projects show average social rates of returns ranging from a low of 9% for higher education in advanced countries to a high of 27% for primary education in developing countries.

The "theory" of investment in human capital and of self-interest is found in one of the most popular management books in the United States today, The One Minute Manager. This book states that people are the most important resource. Yet many managers do not recognize this fact. To quote the book: "It's ironic, most companies spend 50% to 70% of their money on peoples' salaries. And yet they spend less than 1% of their budget to train their people. Most companies, in fact, spend more time and money on maintaining their buildings and equipment than they do on maintaining and developing peole."[4] Adam Smith pointed out, in many ways, that the division of labour, self-interest, and "natural liberty" attributed to the wealth of nations. No one in Smith's time could foresee a nation like the U.S. today, where four-fifths of national income is derived from the earnings of labour. Yet Adam Smith seemed to understand the organization and the function of labor better than we do today. Smith stated: "The difference between the most dissimilar characters, between a philosopher and a common street porter, for example, seem to arise not so much from nature, as from habit, custom and education."[5] Smith also seemed to have recognized that basic education was an investment in a very important form of human capital. "Though the state was to derive no advantage from the instruction of the inferior ranks of people, it would still deserve its attention that they should not be altogether uninstructed. The state, however, derives no inconsiderable advantage from their instruction. . . . An instructed and intelligent people besides, are always more decent and orderly than an ignorant and stupid one. They feel themselves, each individually, more respectable, and more likely to obtain the respect of their lawful superiors, and they are therefore more disposed to respect those superiors. They are more disposed to examine, and more capable of seeing through, the interested complaints of faction and sedition. . . . "[6] Adam Smith also said: "The state can encourage or insist on the general acquirement of reading, writing, and arithmetic."[7] "The education of the common people requires attention from the state . . ."[8] "There is scarce a common trade which does not afford some opportunities of applying to it the principles of geometry and mechanics, and which would not therefore gradually exercise and improve the common people in those principles, the necessary introduction to the most sublime as well as to the most useful sciences.[9]

These statements relate to current problems in the United States. "A Nation At Risk" released April 26, 1983 by the National Commission on Excellence in Education, states that we have many problems in our education system. It says: "Knowledge, learning, information, and skilled intelligence are the new raw materials of international commerce . . . we must dedicate ourselves to the reform of our educational system for the benefit of all--old and young alike, affluent and poor, majority and minority. Learning is the indispensable investment required for success in the 'information age' we are entering."[10] The report also says, "Some 23 million American adults are functionally illiterate by the simplest tests of everyday reading, writing and comprehension."[11] U.S. News and World Report in it's May 17, 1982 issue states that almost one-third of the adult population is functionally incompetent.[12] They are not capable of functioning efficiently in today's complex economy which rests on widely diffused tools for communication, storage, and retrieval of knowledge.

The United States today might want to pay attention to Adam Smith's reference to the importance of the "common people." We certainly need investment in education in the form of college preparatory classes and higher education to continue to lead the world in the number of Nobel Prize winners. However, the United States is currently losing its ability to compete in the area of applying technology to create new products, to make full use of what its scientists and engineers have developed. It may need more attention to the "common people" than "A Nation at Risk" recommends. Adam Smith offered a solution that might work today to encourage basic skills for the 25% of high school students who drop out and perhaps another 25% who get little out of high school. He said: "For a very small expense the public can facilitate, can encourage, and can even impose upon almost the whole body of the people, the necessity of acquiring those most essential parts of education. . . . The public can encourage the acquisition of those little badges of distinction, to the children of the common people who excel in them. . . . The public can impose upon almost the whole body, of the people the necessity of acquiring those essential parts of education or probation in them before he can obtain the freedom in any corporation, or be allowed to set up any trade either in a village or town corporate."[13]

Adam Smith said investment in human capital is a necessary prerequisite for security, peace and stability within a society. "That in the progress of improvement the practice of military exercises, unless government takes proper pains to support it, goes gradually to decay, and, together with it, the martial spirit of the great body of the people. . . . But the security of every society must always depend, more or less, upon the martial spirit of the great body of the people . . . where every citizen had the spirit of a soldier, a smaller standing army would surely be requisite. That spirit, besides, would necessarily diminish very much the dangers to liberty whether real or imaginary, which are commonly apprehended from a standing army."[14] Smith goes on to explain that this investment in human capital not only reduces the need and expense for a large standing army, but it would help eliminate cowardice, which he decries as mental mutilation, deformity, wretchedness, and a great public evil.

Smith states that investment in human capital is also needed to insure a social structure that is conducive to freedom and "natural liberty." "The man whose whole life is spent in performing a few simple operations, of which the effects too are, perhaps, always the same, or very nearly the same, has no occasion to exert his understanding, or to exercise his invention in finding out expedients for removing difficulties which never occur. He naturally loses, therefore, the habit of such exertion, and generally becomes as stupid and ignorant as it is possible for a human creature to become. . . . But in every improved and civilized society this is the state into which the labouring poor, that is, the great body of the people, must necessarily fall, unless government takes some pains to prevent it."[15]

What we in the United States receive at the ballet box in our democratic society depends, to a large extent, on the quality of education the majority of our people have. Better education may help with the solution to many government problems including such areas as current tax laws, the welfare system, rent controls, education, and social security. Both the public and private sectors need the ability to distinguish between resources consumed and resources that are used as investment in human capital. A system of education for the great body of the people, Adam Smith says, "will help to prevent corruption and degeneracy."[16] George Gallop in his book Sophisticated Poll Watcher's Guide says the best government is one that tells the people the truth and then listens to what they say.[17] Of course this assumes a concerned and educated populace. Thomas Jefferson summarized the problem very well with his famous dictum: "I know no safe depository of the ultimate powers of the society but the people themselves; and if we think them not enlightened enough to exercise their control with a wholesome discretion, the remedy is not to take it from them but to inform their discretion."[18] In today's fast paced world this probably means lifelong learning.

Adam Smith has advice for our current education system in America. He explains very well the need for teachers to have good pay. He says it is even more important that teachers be involved and committed and that their self-interest must be for the betterment of their students and therefore society as a whole. What Smith says about the pay of a clergyman he would probably also say about a teacher. "The proper performance of every service seems to require that its pay or recompense should be, as exactly as possible, proportioned to the nature of the service. If any service is very much underpaid, it is very apt to be the meanness and incapacity of the greater part of those who are employed in it. If it is very much overpaid, it is apt to suffer, perhaps, still more by their negligence and idleness."[19] Milton Friedman probably got his voucher system for education from Adam Smith. Smith takes several pages to explain that teachers teach better when they derive some advantage from good teaching. "It is the interest of every man to live as much at his ease as he can; and if his emoluments are to be precisely the same, whether he does, or does not perform some very laborious duty, it is certainly his interest, at least as interest is vulgarly understood, either to neglect it altogether, or, if he is subject to some authority which will not suffer him to do this, to perform it in as careless and slovenly a manner as that authority will permit. If he is naturally active and a lover of labour, it is his interest to employ that activity in any way, from which he can derive some advantage, rather than in the performance of his duty, from which he can derive none."[20] At Spokane Falls Community College I have the opportunity to be involved in my job. I am evaluated by students, I start new courses, I help choose textbooks, I even help write courses and texts. My rewards, both psychic and financial, have been a reflection of my performance. When I taught junior high school in the small community of McCall, Idaho (75 students in 7th and 8th grades) I had the authority and responsibility to be involved and committed to what happened at the school. However, when I taught driver education one summer in Boise, Idaho, the largest school system in Idaho, a system with many "professional educators" and curriculum specialists, I was certainly less committed or involved. I had little responsibility or authority. They gave me lesson plans that told me what to say. They would even turn the film projector on at a certain time whether or not the class was ready. I had little control over my own environment.

T. W. Schultz, of the University of Chicago, points out that teachers today particularly in large school systems tend to serve their self-interest in areas where they have some advantage. "Teachers are much maligned. It is said they are not concerned about the educational achievements of their students. In the large school systems, they join and establish strong teachers' unions. Through them, they bargain for less instructional time, less extracurricular involvement, greater reliance upon union contracts as the standards of professional responsibility, better facilities, more fringe benefits, and promotion and school assignment formulas that will serve their self-interest. They are said to show little or no interest in improving the quality of their teaching."[21] He says we should expect the results we get based on the incentives in the system. "My argument is that most of this might have been anticipated in view of the way schools are organized and administered. Neither the curriculum, the promotion and permissible discipline of students, nor the objectives of the courses to be taught are for teachers to decide. These decisions are placed in the domain of 'professional educators.' In assessing performance it is a dictum of economics that incentives matter, but the incentives to become an excellent teacher have become weak and ambiguous; furthermore, they are badly distorted."[22]

In summary, Smith's "Theory" on investment in human capital recognizes human capital as a public good vital to the wealth of a nation. It is easy to extrapolate from his statements that human capital is one of the most essential elements in the efficient allocation of resources and probably the most important factor of production. Adam Smith helps distinguish between consumption expenditures and investment in human capital (health, skills, and knowledge). Smith's ideas relate to today's problems. Although it appears he would prefer a private system for some segments of education he states: "The expense of the institutions for education . . . is likewise, no doubt, beneficial to the whole society, and may, therefore, without injustice, be defrayed by the general contribution of the whole society."[23]

SMITH BELIEVED IN INVESTING IN HUMAN CAPITAL!

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ELEMENTS OF A FREE-MARKET THEORY OF ECONOMIC PROGRESS

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> Man's behavior in the market relationship, reflecting the propensity to truck and to barter, and the manifold variations in structure that this relationship can take--these are the proper subjects for the economist's study.[1]

In the four decades since Development Economics emerged as a subdiscipline we have drifted far from what Buchanan said economics should be. What is now called Development Economics began after World War II with the conviction that only firm government control and substantial external aid would achieve economic progress in the poorer nations. From its inception Adam Smith's commercial markets were rejected in favor of the pessimistic elitism of the disciples of Keynes, Oskar Lange, Maurice Dobb, or Harold Laski. Those in authority were encouraged to believe that markets were weak and imperfect, if not downright pernicious.

Beginning with Paul Rosenstein-Rodan's proposals for industrializing Eastern and South-Eastern Europe and running through all the work on planning and control by Leontief, Mahalanobis, Chenery, and others, there appeared a strong faith in government officials and a weak estimate of supply elasticities or technical options. The interventionist approach to social issues was in high fashion, and Development Economics was largely a product of that intellectual environment. So the rewards of the economics profession went to those who contributed to the mathematics of social engineering.

Dependencia and Structuralist schools of economic politics have thrived on blaming foreigners and exogenous events for the domestic tribulations of the ill-governed nations. Four decades have passed, however, and though causality is an ever present issue in economics, certain broad conclusions are clear from the evidence: standard economic analysis is relevant; furthermore, market-oriented economics have been successful in providing higher individual living standards and greater individual freedom than dirigiste alternatives.[2] Where the evidence is questioned, disagreements stem from inappropriate comparisons. We expect people to be better off now than several decades ago. The important question is why are they less well off than those in other nations which started from a similar situation.[3] Only recently have we begun to ask the obvious question: If government is to be the prime mover in economic growth, how well are the less successful nations governed, and what does visible misgovernment imply?[4]

It is shocking that the sources of economic progress should still be in question. Over the centuries of its existence as an independent intellectual activity, economics has been about markets. The discipline's finest intellects have concluded that unfettered markets produce not only the efficient but also the good society. What we have seen in the passions of Development Economics is merely a phase in the ongoing confict between democratic faith in individuals (which must underlie all market systems) and the eternal urge of the elite to control and educate.

The behavioral assumptions of past theories of economic growth were frequently false. Poor people are not another species which needs guidance to do what is in its own best interests and tutoring to adopt more profitable ways of doing things. Poor people demonstrate every aspect of human behavior--including an intense capacity to work and create when not constrained.[5]

Development economists have, in various order, purveyed: industrialization as an end in itself, abstract sectoral models, a preoccupation with the distribution of wealth rather than its creation, balanced industrial growth, surplus labor models, leading sector models, import substitution policies, national economic development planning, foreign exchange regimes which justified two-gap Keynesian models, population policies, stages-of-growth theories without number, and foreign aid administered by government officials.

Development economists chose not to believe that supply elasticities were favorable, and that market-determined foreign exchange rates and interest rates would induce people to act. They accepted cultural differences, the existence of poverty, and "political reality" to justify policies which defied economic common sense and could result only in continued demands for foreign aid. Development economists have much to answer for, particularly since there was always a small group led by Peter Bauer, who had the courage to argue that what was popular and well funded was not necessarily right. In forsaking their free-market heritage development, economists betrayed those whom they were presumed to help.[6]

Now people in the Less Developed Countries, and even their government officials, speak of a free-market approach to economic growth. Privatization and deregulation were not forced upon them by "conditionality" or "policy dialogue," or the offer of "structural adjustment assistance." Markets again are in the ascendency and call for intellectual support.[7]

A theory of economic growth must be the best current explanation of the process by which growth occurs. It should explain the historical record better than alternative theories; and, being the best current explanation, it would also be the best current predictor of future patterns of economic growth. Economic growth is an observable and sustained, but not necessarily measurable, increase in the level of well being of the people in a given nation. Any useful definition of economic growth must include factors such as high levels of personal freedom, visible examples of numerous individuals who have achieved great economic and social success, and bright expectations for the future.[8]

Economic growth results when individuals use their imagination, take risks, and work hard in what they conceive to be the best interests of those they cherish. Perhaps most important, economic progress can only occur when individuals are assured that they will own what their efforts produce. In other words, economic progress is first and foremost about microeconomics. This is greatly to our advantage since the elements of microeconomics are also those most convincingly rooted in economic theory.

Nothing we have said denies the need for a framework of governmental institutions within which individuals can operate, but it does move microeconomics back to center stage. It requires that macroeconomic policies be founded upon microeconomic theory and not derived from aggregates or abstract notions which exclude the roles of relative prices, wealth effects, and substitution effects.[9]

Secure yet flexible ownership rights determine the pattern of incentives which ultimately dictates the form and pace of economic progress. People must be free to use or sell their professional skills, to accumulate savings, and to hold or dispose of all other forms of property with the minimum governmental constraint. This is the fulcrum for any lever of successful economic policy.

Throughout less successful nations the economic rights of individuals are constrained by inappropriate legal systems, by stifling government regulations, and by the operations of state monopolies. The first policy conclusions to come from a revamped theory of economic growth must explain the process of getting to the competitive state from the stagnant, dirigiste state at the lowest possible cost to society. This will inevitably mean privatizing many functions previously accepted as the sole responsibility of governments. In the longer-run, the response to alleged diseconomies, externalities, or other market imperfections must be to introduce competition rather than to regulate.

Moving to successful policies will not be costless. As England's landed gentry fought the repeal of the corn laws in the early nineteenth century, so we must expect the intellectual gentry of the less successful nations to resist the loss of their privileged positions in society today.

Legal systems--the means by which we ensure human rights over assets which people accumulate--must be at the heart of any new theory of economic growth. In a world of rapid change, improving ways to encourage easy entry and exit from all forms of business is increasingly important.

Rewards are necessary for people participating in the dynamic process of creating wealth in every form, along with discouraging them from using their skills and talents in the confict-generating process of static redistribution. A way is needed to de-politicize economic decisions. Ensure that managers and entrepreneurs are not told to do one thing and then rewarded for doing the opposite. These are some of the common sense conclusions we seek.

There must also be a resolution of the conflict between short-term humanitarian relief programs and their long-run effects on economic growth. The "great international humanitarian urge" which the United States has demonstrated since the end of World War I is quickly undermined when harnessed to the stagnant bureaucracies created by Development Economics. A new and more positive role is essential for the flows of international generosity we call foreign aid.

All of the foregoing, and much besides, must be embodied in any new theory of economic growth. We cannot expect a new and competitive paradigm from development economists; indeed, their vested interest is in theories of the past. It is up to economists in general to apply the standard tools of their trade to the current problems of economic growth.

What follows is a brief statement of some areas where the greatest change in attitude will be required if a new paradigm is to emerge.

Behavioral Assumption

The simple assumption that individuals alone know what is best for themselves and those they love has withstood the test of sustained attack in economics. We have nothing better to work with at this stage of human development. Furthermore, this assumption provides an ethical and a moral foundation for elevating the individual which is lacking in all alternatives.

Incentives and Responsibility

Incentives, both positive and negative, induce people to act. Also, incentives related to action and results have the effect of tying responsibility to individual action in a way which alternative systems fail to do. We need to know more about the relation between the pattern of incentives and the underlying system of ownership rights, but much of the required analysis has already been worked out.

Income and Wealth

Human beings are perceptive. They know that wealth is accumulated income, and that the two are inseparably linked. If we constrain the ownership of wealth in some way, we may expect people to react perversely in terms of their incomes, and vice versa. The implications of this are profound. Worker management does not function as expected unless it is also worker ownership. People do not manage assets they own in the same way that they manage assets they can never own.[10]

Distribution of Ownership Rights

The initial distribution of ownership is one thing; the subsequent dynamic process of continuing redistribution, an essential part of economic growth, is another. Technical change, for example, should be examined in terms of the dynamics of changes in ownership.

Enforcement of Ownership Rights

The value of any asset is determined by its opportunity cost. The opportunity cost is determined by the productivity of the asset and the degree to which its ownership is defined and enforced. It is not easy to sell and transfer that for which one has no clear title. Ownership rights are established and enforced more effectively and efficiently if the cost of measuring and monitoring them is low. Technology enters the picture again with continual improvements in the ability to monitor assets. The Law should protect against failure to fulfill contractual obligations in ownership transactions. Once more we should note the assignment of responsibility which ownership entails, and which non-ownership, or the collectivist model, fails to provide.

Trade, Barter and Exchange

By trade and exchange we escape the dead hand of self-sufficiency. By trade and exchange we are permitted to specialize in what we do best, hence allowing others to provide for so many of our wants. It is by encouraging open trade and exchange of services and commodities between individuals, groups and nations that humanity progresses. There is no substitute for domestic free trade. And the case for international free trade also stands unchallenged.

Our approach to commercial policy and international trade will have to consider anew the vital role of imports in the process of economic growth. It is strange that there has never been an argument for import-led growth. Perhaps the issue is clouded by the high exchange-rate policies of the less successful countries--policies which subsidize only the imports of the government sector and other favored groups. We have in mind a free-market argument for the elimination of tariff and other barriers to trade. Imports provide not only the incentive goods of which Marshall spoke, they also fulfill other growth-promoting functions.

Imports transfer technology. Copying, emulating, modifying and ultimately designing--these are the steps from technological backwardness to technological respect in the eyes of the world. Imports force the old and established industries and the failed government monopolies to restructure, redeploy and divest. Imports dampen domestic inflationary policies by improvident governments. Imports permit economic flexibility and provide competing sources of supply uncluttered with fixed domestic production costs. Imports, when coupled to rational foreign exchange rate policies, create a widespread and urgent need to produce the means to pay for them. Without imports no country can know the full range of its trading opportunities.

Prices, Information Flows and Communications

Prices have several roles: to inform, to ration, to induce, to allocate. But the key role is to contribute information. Prices embody information concerning the present and the future. What prices have to say may not always be welcome, but if economic flexibility is a key element in the growth process we must pay dearly if we distort prices.

To improve information flows, exscind communications monopolies. Government telephone, postal and radio monopolies raise the cost of information to the common man, delay the introduction of new technologies and retain skills and resources which should go to other and more valuable activities.

Distribution of Resources

Allow resources to flow to those who will use them to create wealth. The process of recognizing and eliminating the sources of rigidity in the flow of resources and skills into their most productive use during the growth process needs studying.

Distribution of Output

It is imperative that output be distributed on the basis of what people want, as demonstrated by what they are prepared to pay for. The distribution of output must correspond basically to economic behavior and the manner in which individuals choose to use their talents. There are those who consume first, and there are those who save and accumulate. The distribution of output must relate to responsibility, productivity and hence the structure of property rights.

Government: The Power to Coerce

Government plays a vital role in the growth process. Its actions should facilitate entrepreneurial activity at every turn. However, the legitimate roles government fulfills in promoting social cohesion and in elevating ethical standards are not advanced if the civil service gets into the business of operating inefficient state monopolies and transferring wealth to favored select groups.

It is important to understand the difference between marginal and average tax rates and to acknowledge the ability of a government to tax a country into poverty. Consider Jamaica. As Alan Reynolds points out:

> Jamaica has a top marginal tax rate of 57.5 percent that kicks in at $2,500 a year. In Jamaica if you make $1,200 a year or less, you get free food. If you make $1,300 you lose the free food and start to move into a tax structure that hits 57.5 percent by the time you're making $2,500. In that type of situation you'll think very carefully before you earn, or at least report, any income above $1,200. If you're capable of earning $2,500, you'll probably leave the country.[11]

The Key Role of Failure

A major factor in economic growth is the rapid elimination of failed enterprises, activities and instructions. The failure rate of firms in the less successful countries is shockingly low. One would suspect that many firms and activities are kept going when they should be replaced by more successful alternatives. Construct systems of ownership rights to permit rapid evolution into new forms of economic activity. Allow people to choose what level of risk they want. Then let the result police itself by permitting failure as well as success. Too often governments cosset people, and in protecting them from the choice of greater risk, deny them the fruits of growth.

Ethics and Personal Responsibility

People in successful nations display obvious hard work. Such nations also demonstrate a connection between reward and responsibility.[12] These characteristics need to be examined. Successful nations have an atmosphere of ethical conviction which is missing in failed, dirigiste societies. The ethical and moral underpinnings of successful societies appear to be related to individual behavior. It is no accident that the most perceptive foreign observers of the United States identify us as having " . . . an all-pervading religiousness, . . . a sense of duty . . . " We may fail to recognize ourselves, but others see us as driven workaholics with a moral mission for the rest of the world.[13] This facet of success cannot be disregrded.

In conclusion, too much intellectual effort has gone into the discovery of exceptions and special cases. We have neglected to sustain and strengthen the application of standard microeconomic analysis to the process of economic growth. We have failed to integrate new tools of analysis and new areas of discovery. Perhaps above all we have been timorous in not acknowledging that there has to be a moral purpose and an ethical commitment if growth is to succeed.

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2. On the Dependencia and Structuralist ideologies see: Helen Hughes, "Some Policy Lessons of the Development Experience," The Group of Thirty, Occasional Papers No. 16, New York, 1985. pp. 7-10.

3. Korea provides a reasonable benchmark: one with economic handicaps which the pessimists told us should have stifled progress. In the late 1940s, Korea was just one of the pack with India, Burma, China, and others in the region. Worse, "until the 1960s, Korea was regarded as an economic 'basket case' because it was thought to be too concerned with Confucian and Buddhist spiritual issues to consider business activities and economic growth important. Its population was perceived as insufficiently business oriented!" (Hughes, ibid, p. 14). Today, Korea is a middle-income nation and an economic power, offering its citizens a standard of living far exceeding that available to the average Indian or Chinese. Furthermore, there is in Korea a degree of individual freedom and a practiced right of dissent which far exceeds that available to citizens of the majortiy of nations at similar income levels.

4. Look, for example, at Jean-Francois Revel, "How Well is the Third World Governed?," Wall Street Journal, Thursday, November 5, 1981.

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8. For a sampling of how arid methodology in this area has been see: Harvey Leibenstein, "What Can we expect from a Theory of Economic Development?" *Kyklos*, Vol. XIX, Fasc. 1, 1966, pp. 1-21; Emile Grunberg's comments on the Leibenstein article in *Kyklos*, Vol. XX, Fasc. 1, 1967, pp. 962-967; and Paul E. Koefod, "Prospects for Essential Theories of Economic Development and Growth," *Indian Economic Journal*, Vol. XVIII, No. 3, January-March, 1976, pp. 271-289.

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11. *Manhattan Report*, Vol. V, No. 3, 1985. p. 8.

12. Peter Drucker has some interesting ideas on the relation between ownership, knowledge, power and responsibility in his book: *Managing in Turbulent Times*, Harper & Row Publishers, 1980, pp. 189-192.

13. Luigi Barzini, "The Americans", *Harper's*, December 1981. pp. 29-36, 83-85:

> Behind their compulsion to improve man's lot was at first an all-pervading religiousness, later the sense of duty, the submission to a God-given code of personal behavior, the acceptance of a God-given task to accomplish and of all the necessary sacrifices. Few foreigners understand this, even today. The United States looks to them like the triumph of soulless materialism.(p. 35)

ALL AMERICAN ECONOMICS--MADE IN THE U.S.A.

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Sam Walton, an extraordinary capitalist, patriot, entrepreneur, founder and chairman of Wal-Mart stores, is currently pushing a "Buy American" campaign which could nudge the American incentive system enough to prove, once more, that free enterprise delivers the goods. Walton, who has voiced great concern over our economy's historically high balance of trade deficits and the attendant loss of jobs and wealth flowing out of the country, says he knows what we should be doing and how we should get it accomplished.

This writer is reminded of Edmond Burke, who wrote long ago, "How often has public calamity been arrested on the very brink of ruin by the seasonable energy of a single man?" Indeed, late last year, Walton gave the merchandise managers of his $6.4 billion company not only a new philosophy, but a mandate: "Find products that American manufacturers have stopped producing because they couldn't compete with foreign imports." Walton not only urged his people to "Buy American;" he invited other retailers to get with the program.

Rugged Economic Individualism

The "Buy American" campaign represents a rather well-defined extension of Chairman Walton's philosophy as it was communicated to the suppliers of his 800-unit discount chain:

> Our Wal-Mart company is firmly committed to the philosophy of buying everything possible from suppliers who manufacture their products in the United States. We are convinced that with proper planning and cooperation, many products can be supplied to us that are comparable, or better, in value and quality to those that we have been buying offshore.

As Walton recently highlighted in a letter to 3,000 of the chain's domestic suppliers, between 1981 and 1984 an estimated 1.6 million American jobs were lost to imports. In fact, in the calendar year just ended, non-oil-related imports grew $70 billion, a 33% increase. Additionally, the balance of trade deficit grew by 78% to $123.3 billion for calendar year 1984.

Sounding the call, Walton said, "Something can and must be done to reverse this very serious threat to our free enterprise system." Walton believes retailers can be equal opportunity purchasers while still offering customers good quality and price combinations in a price range which will not squeeze overall profit margins.

A Production-Marketing Renaissance

Although he is an avid free trader, Walton and his executives are willing to work with American manufacturers, to help them achieve the price and quality combination that could put them back into the ball game. Essentially, the "Buy American" plan gives the American manufacturers the same terms and cooperation that are currently extended by Wal-Mart to foreign manufacturers. This does not make work any easier for Wal-Mart, however.

It involves aid to domestic manufacturers so that products can be produced to specification, and it means providing vendors with longer lead time. Beyond that, the "Buy American" effort also involves Wal-Mart's teaming up with its vendors to tighten quality controls. In some cases, the aid goes to the extent of supplying domestic letters of credit.

Profits Promote Progress

What is at stake? The new "All American Savings" promotional program says it all: "Wal-Mart--Keeping America Working and Strong." According to Wal-Mart World, "The intent of the program is to show our customers that we wholeheartedly support buying American-made products which represent quality at a value."

In Wal-Mart's enlightened self-interest, customers are being created at the same time that jobs are being developed in rural America. Early this year, while the thrust of Wal-Mart's program was with its vendors, the chain was also pitching customers to buy American goods. Although such an approach may seem to defy the conventional wisdom of free trade economics, it is not written in the stars that we have to continue to lose markets to overseas manufacturers. Neither is it a foregone conclusion that their quality has to be better than ours.

If the Price is Right

Each pricing situation will be judged on its own merits and, of course, the overriding consideration will continue to be the need for Wal-Mart to remain competitive in its 20-state market. It is a complicated process that involves lead time, payment terms, guaranteed orders and more than the usual amount of paperwork.

Also of importance is the fact that Walton expressed a willingness on the part of Wal-Mart to pay a little more in some cases for goods manufactured in the U.S.A. and accept a reduced markup that Wal-Mart puts on those goods. However, Walton did not say that his company would pay significantly more and endanger the company's distinctive market niche as a discount store.

Walton has put manufacturers on notice that they will have to make an equal commitment:

> In turn, our American suppliers must commit to improving their facilities and machinery, remain financially conservative and work to fill our requirements, and most importantly, strive to improve employee productivity. This means that American producers will have to be more "market driven" instead of continuing to be traditionally "product driven."

The "Buy American" campaign has gained momentum, as evidenced by the large number of backhauls of products manufactured in Wal-Mart's trade territory. Walton recently cited successful cases of working with vendors on "bringing production back to our shores."

Wal-Mart ordered 400,000 portable electric fans from Lasko Metal Products. The more than $3 million worth of fans will be produced predominately in Franklin, Tennessee, and Fort Worth, Texas. In the process, the Lasko employment roles will grow by 30%, bringing them back to where they were a decade ago.

In 1983, Wal-Mart imported all of its dress shirts; however, last year 40% of the dress shirts were produced domestically. Capital Mercury Shirt Co. has, as a result of Wal-Mart's drive, brought back to the continental U.S. some of its production and even hopes to expand some of its facilities to meet the needs of other retailers.

Wal-Mart is also selling more domestic flannel shirts, as it has been determined they can be produced on a competitive basis in the U.S. Farris Fashions, Inc. in Brinkley, has a $600,000 contract for 240,000 flannel shirts--one-tenth of what the company anticipates it will sell next winter.

Julie Girl, a manufacturer of ladies' sportswear and loungewear, has received enough Wal-Mart contracts to create about 200 more jobs, as Wal-Mart has extended a longer lead time in allowing the manufacturer to fill orders. The result has been better production planning and more efficient plant operations through the lowering of costs and overhead.

Similar arrangements have been made with Flanders Industries, which employs 100 people with sales of $7 million a year. Wal-Mart has signed a $469,000 contract with the Fort Smith-based manufacturer of casual furniture. Previously, the outdoor stacking chairs had been purchased from Taiwan. By agreeing to pay Flanders when the chairs are shipped, rather then 30 days after the order is shipped, Wal-Mart is helping Flanders to operate at less of a competitive disadvantage than many overseas firms. The new contract will add about 30 more employees next year.

ON THE ROLE OF THE STATE IN A PRIVATE ENTERPRISE SYSTEM

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The Problem of Property Rights

The tangible components of an economic system consist of a physical environment, a collection of individuals, and a set of "rules." These three components are interdependent and interact among themselves (Vining, 1956). The rules of an economic system prescribe the separate, group, and organizational behavior of the individuals within the system. Such rules take concrete form in constitutional provisions, legislative acts, judicial decrees, executive proclamations, administrative regulations, and so forth. The rules of an economic system determine its classification. In particular, a private enterprise system is distinguished from other types of systems by virtue of the fact that the rules of a private enterprise system prescribe that (1) the physical means of production are to be privately owned, (2) the initiative for production is to come from private sources, (3) the incentive for production is to be private profit, and (4) losses are to be a matter of private responsibility (cf. Schumpeter, 1943, p. 113, and 1946, p. 801).

Of course, the nature of a private enterprise system is not adequately described by an enumeration of its general features such as the one given above. For one thing, the above list conveys no information about the contents of the property rights that are distributed among the private agents of the system. To some extent, i.e., when the costs of "internalizing" externalities through private contracts is not prohibitive, this problem is resolved through contracts among private parties in a Coaseian-type way (Coase, 1960). But even in these cases, there remain questions relating to which and how contracts are to be enforced (cf. Hayek, 1948, p. 113). In any event, property rights must be defined and made secure; and a means for adjudicating disputes, enforcing contracts, and modifying property rights must be provided.

Because of the state's monopoly of power and, therefore, its efficiency in the area of enforcement, many eminent proponents of private enterprise systems, e.g., Simons (1934, p. 4f.), Knight (1951, p. 16), and Friedman (1962, p. 34), consider the definition, promulgation, and administration of the laws of property and contract to be a proper function of government. But it is crucial that the state not be arbitrary in performing the functions of defining, securing, and modifying property rights; adjudicating disputes; and enforcing contracts. That is, the state must perform these functions in accordance with the principle of promoting and maintaining freedom of entry into and exit from markets, taking especial care that "unnecessary" privileges are not created, so that the rationale of a private enterprise system is not impaired.

The Rationale of a Private Enterprise System

A private enterprise system is justified by two arguments: A private enterprise system promotes individual freedom, and the working properties of such a system is superior to those of alternative systems. The promotion of the freedom of the individual is provided partly by the ability of the individual to freely choose as to whether or not and to whom to sell his labor services. In addition, the individual is free to generate an income in the form of profits through his own initiative and to, separately or concomitantly, accumulate income-producing property. The possibility, as well as the reality, of acquiring an independent income increases the choice set of the individual and, in particular, reduces the vulnerability of the individual to the influence, dominance, and even coercion of others, including the state. Moreover, the exercise of individual initiative tends to create an environment in which nonconformity is more readily acceptable so that, for this reason alone, the range of individual choices is enhanced. Finally, the freedom of the individual is augmented by his ability to dispose of his income or wealth in accordance with his preferences in such a system.

As for the performance properties of a private enterprise system, there is general agreement among mainstream economists that, when freedom of entry and exit obtains, a private enterprise system performs the Knightian functions (Knight, 1933) of fixing standards, organizing production, maintaining and improving productive capacity, and adjusting consumption to production within short periods better than any alternative system. That is, it is generally agreed that a private enterprise system in which markets are free, rations goods more effectively, allocates resources more efficiently and is capable of generating a greater rate of economic growth than any other (real world) system. Moreover, the frequent and severe criticisms of the "failure" of private enterprise systems to generate stable and justly distributed income streams seems to be largely misdirected. In particular, it has been convincingly argued that, if inappropriate governmental policies are avoided and, instead, appropriate governmental policies are pursued, a private enterprise system will produce a stability of income and an equity in its distribution that will compare favorably with that of any alternative system (Simons, 1944; Friedman, 1962). Nevertheless, as has been emphasized by Hayek (1962), for a private enterprise system to work well, a strong ethos is required in which a belief in individual responsibility and a belief in material reward in accordance with the value to buyers of services rendered are essential. If these beliefs prevail, the distribution of income that is generated by a private enterprise system whose markets are free will be considered just; and only when the distribution of income of the system is considered just is the system truly viable politically (Daniel, 1979, p. 316, and December 1980, p. 6).

The case for a private enterprise system is indeed persuasive. But it depends entirely on the ability of agents to freely enter into and exit from the markets of the system. That is, if entry into and exit from the markets of the system are precluded in any decisive way, the freedom of the individual is not enhanced by the existence of the system's markets; and the system's efficacy in rationing goods, efficiency in allocating resources, rapidity of growth, and equity in the distribution of income will not be as great as they otherwise would be. Thus, if a private enterprise system is to be justified, it is essential that barriers to entry and exit be eliminated and avoided; and it is the proper function of government to so define, secure, and modify property rights; adjudicate disputes; and enforce contracts that barriers to entry are eliminated and avoided.

The Problem of Barriers

Whether in product or labor markets, barriers to entry are of two types: Those that are endogenous to the operation of the markets of a private enterprise system and those that are a consequence of governmental intervention (cf. Daniel, July 1980, p. 8f). In their analyses of product markets, economists have traditionally emphasized the first or "private enterprise" type of barriers (*e.g.*, Bain, 1956), most of which may be attributed to the behavior of (private) entrepreneurs and some of which are illegal. Among the barriers of this type that are usually cited, in addition to Adam Smith's explicit or implicit conspiracy (1893, p. 116), are knowledge of and experience with specialized production processes and particular markets; secrecy; product differentiation, branding, and sales promotion; predatory, discriminatory, and limit pricing; accessibility of financial capital; economies of scale and scope; the cartelization of markets; and the control of essential raw materials. However, the effectiveness of private enterprise barriers in deterring entry into product markets is open to serious question (Daniel, 1982, pp. 9-12, and 1984, pp. 307-309).

In this regard, the mobility of personnel, especially personnel at higher echelons, renders tenuous those barriers that are based upon secrecy, experience, and knowledge of production processes and markets. Activities on the part of sellers which are intended to influence the choices of buyers directly, such as differentiating products, branding, and sales promotion, are clearly a part of dynamic competitive market processes insofar as they are required not only for maintaining and augmenting market shares, but also for the purpose of gaining entry. Consider, for example, the probable consequence of attempting to introduce a new consumer's good without using advertising. It is the multidimensional role of product differentiation, branding, and sales promotion that explains the inconclusiveness of empirical investigations on the effect of advertising on competition (see Comanor and Wilson, 1979).

Legalities aside, predatory and discriminatory pricing similarly have more than one role in a dynamic competitive environment. In particular, they can be used to attain entry as well as to resist entry. In fact, "special introductory offers," which are a mild form of such pricing, are conventionally used by firms that are attempting entry. In any event, the case for the use of predatory and discriminatory pricing as a barrier to entry has not been substantiated (McGee, 1958; Koller, 1969; and Elsinga, 1970).

Also questionable is the efficacy of limit pricing in preventing entry, since not only will anticipated net receipts differ among actual and potential entrants and "existing" firms, i.e., firms whose products are established in the market under consideration, but also what constitutes *ex ante* normal profit will differ among these firms. This is not to say that existing firms will be wholly oblivious to the effect of their pricing policies on entry. Existing firms that can influence the prices at which their products sell will ordinarily, if they are to survive, anticipate the effect of their pricing policies on the behavior of potential entrants in the same way that they will anticipate the effect of such policies on the behavior of existing firms which are capable of supplanting them in the market.

Free capital markets do ration financial capital in accordance with the likelihood of success (cf. Stiglitz and Weiss, 1981, p. 407). That capital markets ration credit imperfectly is evidenced by the fact that lenders do incur losses. But there is no convincing empirical evidence or theoretical arguments that support the proposition that free capital markets contain a bias against the financing of potentially profitable new ventures.

As is now well known (cf. Daniel, 1967, pp. 350ff), economics of scale *per se* are insufficient to prevent entry; but absolute cost advantages are sufficient to do so. Absolute cost advantages are the result of process innovation and improvement and are thus at least partly fortuitous with respect to their distribution between existing firms and entrants. Accordingly, an absolute cost advantage may be a cause of, rather than a barrier, to entry.

Legalities aside, explicit and implicit collusive free-market agreements are conspicuously weak; and so are cartels that are *not* directly and aggressively reinforced by government's direct use of its police power (Armentano, 1972). The fragility of such arrangements is to be attributed to the fact that they are not barriers to entry; that is, barriers to entry are required to sustain them.

The only traditionally cited free-market barrier that appears to be unequivocally effective in preventing entry in the long run when economic profits exist is that of the control of an essential or unique factor of production. Consider in this regard the market position of the De Beers Company. However, the essentiality or uniqueness of a factor of production depends upon technology, which, partly in order to effect entry, is constantly changing. Accordingly, due to the substitutability of factors, especially in the very long run, which can be very short in calendar time, such a barrier is extremely difficult to erect.

Although, on the whole, the effectiveness of private enterprise type barriers is questionable, few economists are prepared to recommend the abolition of either the Antitrust Division of the Department of Justice or the Federal Trade Commission. However, because of the ambiguities relating to traditional free-market barriers, it is difficult to define a positive role for these agencies in an overall program for the promotion and maintenance of free, competitive markets. Perhaps, the purpose of these agencies can best be served by their simply maintaining an aggressive and ubiquitous existence.

Although private enterprise type barriers may be said to be relatively innocuous, the same cannot be said about barriers in product markets that are associated with governmental intervention. Almost all mainstream economists have long recognized the harmful effects on a competitive order of voluntary and involuntary import quotas and tariffs, local building codes, licensing, patents, and the like, as these have been almost universally implemented. No doubt, some forms of these types of intervention have social merit. However, as Adam Smith (1893, p. 116) noted, such governmental intervention, insofar as it represents or induces special interests in its imposition and/or maintenance, as it usually does, either "facilitate[s]" or "render[s] necessary" the cartelization of markets; and the cartels so fostered may endure "as long as the regulations of police which gave occasion to them" (1893, p. 63).

Smith (1893, p. 597) also condemned, as did Henry Simons (1934, p. 18) and as do most contemporary economists, the granting of legal monopolies through de facto permanent certificates of convenience and necessity. Although recent efforts at deregulation in the communications and transportation industries have mitigated somewhat the injurious effects of public-utility type regulation on economic freedom and the workings of the system (see Daniel, 1964), there is still a large segment of the private sector that is unjustifiably protected from competition by virtue of its public utility status. In any event, the current demands for protectionism threaten to offset some of the beneficial effects of the recent deregulatory efforts.

As is true in the case of monopolies in markets for products, supply-side cartels are unlikely to be sustainable in labor markets without direct governmental intervention on their behalf. As happened in the United States during the period 1932-1946, intervention on behalf of labor unions can nurture monopolies of awesome power. During that period, legislation was enacted that required the recognition of and negotiations with labor unions. Of course, good-faith bargaining with certified unions is still legally required. Then, however, unions were exempt from "ordinary laws" and in fact permitted to engage in "legalize[d] violence, coercion, and intimidation" (Hayek, 1948, p. 117). Then, laws requiring certification and fair labor standards directly enhanced and/or were used to enhance the monopoly power of unions; and they do so now.

The monopoly power of labor unions stems from their ability to legally control entry, which in turn is based upon their ability to legally control wages. As Simons noted (1944, p. 18), "control of wages is control of entry, especially where seniority rules are in force. . ." The control of wages is, however, the primary economic function of labor unions. Thus, the exercise of the primary function of labor unions is equivalent to the erection of barriers to entry in labor markets, which surely requires the consent of government, if not the direct application of its police power.

Concluding Remarks

It has been argued here that a fundamental role of the state in a private enterprise system is that of defining, promulgating, and administering the laws of property and contract so that freedom of entry into and exit from markets is maintained. The maintenance of freedom of entry and exit requires the diligence of the state against practices on the part of firms that tend to monopolize product markets; but, more importantly, it requires that the state abstain from virtually all forms of direct intervention in markets for both goods and services, since such intervention seems almost invariably to be or to lead to an encumbrance on entry or exit, a restraint on competition, a privilege.

Total or near total abstinence from direct intervention in markets by the state is difficult to achieve, especially since support for such intervention often comes from groups who are otherwise staunch defenders of free enterprise, which tends to make a variance from a free-market regimen acceptable, if not respectable. It apparently is easy to believe that intervention can be limited to the particular intervention which one is advocating. But such is not the case. To paraphrase Schumpeter (1940, p. 2), intervention immediately leads to interventionist interest and brings forth a clamor for additional intervention. If a private enterprise system is to perform in accordance with its promise and, thus, to be as politically secure as it can be, all agents must be precluded from successfully petitioning the state to intervene in their interest or, alternatively, must be subjected to the discipline of competition, just as if a competitive order for all were constitutionally prescribed.

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SMALL BUSINESS AND REGULATION--FOE OR FRIEND?

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Background

The last several years have seen a national movement to lessen regulation in several commercial arenas. Transportation, communication and finance are perhaps the key industries which have come under intense charge. Even though the specific effects of some aspects of the lessened regulation policies are still unknown from a consumer point of view, the general feeling toward these efforts by the small business sector of the economy has been favorable. Lessened regulation means change, change means new opportunity, new opportunity means innovation, and innovation is the strength of small enterprise in a free market economy. Opportunities have been created for a wide range of enterprises from smaller airline companies to smaller telephone equipment manufacturers to discount brokers.

Much of the impetus for regulatory reduction has come about from a realization on the part of policy makers that coping with the vast number of federal, state, and local regulations demands increased resources within small business. As the SBA's report on paperwork stated:

> Government paperwork at all levels is an expensive burden passed on to American consumers in the form of higher prices. American small business finds the requirements at all levels of government bewildering. Small firms lack the resources including sufficient personnel to meet paperwork demands. The time requirements to complete paperwork are barriers to competition. Even though government agencies are aware of paperwork problems, they need assistance from small business and state and federal legislative bodies to enact solutions.[1]

Small Business - Anti-Regulation

Continuing surveys by the U.S. Chamber of Commerce and the National Federation of Independent Business indicate that small business practitioners repeatedly rank government regulation as a key problem that small firms must overcome. Not only must small businesses deal with governmental regulations but they face an inherent disadvantage in developing effective strategies. Compared with large businesses the smaller firms generally have less capability to control their future. Smaller businesses usually have less political influence, fewer resources for public relations, weaker voices in industry, less available credit lines, and less impact with legislative bodies.

The former motto of the Boston Globe - "The world is governed too much," is especially relevant for small businesses in the United States.

A 1979 study by the Small Business Administration showed that the nation's 10 million small businesses spend $12.7 billion annually to comply with government forms and reports. Of this total, federal regulatory compliance accounts for $10 billion. Milton D. Stewart, the SBA's chief counsel for advocacy, reported as follows on the SBA's Paperwork Measurement and Reduction Project in testimony before the U.S. Senate Select Committee on Small Business:

1. Small businesses file over 305 million federal forms a year totalling more than 850 million pages and containing over 7.3 billion questions.

2. The average annual cost per small business firm to comply with government reporting requirements is $1,270.

3. Of reports subject to the federal government paperwork control process, 43% are mandatory. The balance is either voluntary (33%) or benefit-related (24%).[2]

4. Seventy-nine percent of the time, bureaucratic estimates of the time burden for a firm are significantly lower than estimates reported by firms completing the forms.

5. The most complained about forms are related to taxes, ERISA, OSHA, EEO and affirmative action plans, census, and government procurement.

6. Ten regulatory agencies account for 60% of the time spent preparing federal reports.[2]

Hearings conducted in Washington, DC by this Senate committee focused on the following additional disclosures of the federal paperwork problem:

1. Federal agencies require small businesses to file millions of sheets of paper per year.

2. The cost of federal agencies is as high as $20 billion a year, with an equal $20 billion cost borne by small business.

3. The Office of Management and Budget lists 6,000 forms in public use.

4. Small business spends 130.5 million hours filling out forms.

5. Small business generally complies with paperwork requirements of federal, state, and local governments.

6. Federal and state agencies attempt to work together, but the level of paperwork is growing.

7. There is often no increase in the productivity of business in spite of compliance. Frequently the costs mean a decline or static productive base for small business.

8. Small businesses often have neither the time nor the ability to make recommendations to federal regulatory agencies to simplify or alter their forms.[3]

Those involved in managing the small enterprise usually view government regulation as unwanted and unneeded interference. The Chemical Bank of New York commissioned a survey of small business owners which revealed the following:

1. Owners criticized excessive governmental regulations and burdensome paperwork.

2. Owners are greatly concerned with the cost of compliance and consider many regulations unnecessary.

3. Owners believe that regulations are oriented toward big businesses which have different problems from those of small firms.[4]

The Other Side

However, there is another side to regulation. Not only is this type of regulation fostered by government but often surprisingly it is sponsored, and enthusiastically endorsed by small firms and independent professionals. This side of the regulatory coin is occupational licensing. Occupational licensing, a growing form of regulation, is a common form of state regulation that affects most businesses and professions.

"People of the same trade seldom meet together, even for merriment and diversion, but that the conversation ends in conspiracy against the public, or in some contrivance to raise the price." This statement written over 200 years ago by Adam Smith in The Wealth of Nations, may well describe the present condition of occupational licensing laws.

The history of occupational licensing in Virginia, the first state to regulate an occupation, is typical of the national trend. In 1639, the colonial legislature passed a law regulating the practice of medicine. The State Board of Medicine was created in 1884 to regulate the healing arts. By 1900, four additional health-related boards were created to regulate dentistry, pharmacy, embalming and veterinary medicine. During the first half of this century, occupational regulation was extended into several non-health professions such as architecture, real estate and building contracting.

Between 1884 and 1942, 7 new boards were created, since 1942, 16 new boards have surfaced. The acceleration of regulation had become a societal norm, not only on a state-wide basis but on a national scope. During the past few years, various state legislatures have considered licensing auctioneers, home improvement contractors, pet groomers, sex therapists, television repairmen, electrologists, data processors, appraisers, professional salespersons and dozens of other groups.

State officials and others concerned with occupational and professional licensing today face at least five major issues: (1) sharp increase in the number of groups requesting licensure; (2) questions about the organization, structure and composition of licensure boards; (3) evaluation of the performance of licensure boards; (4) ways to assure the public of the continuing competence of licensed practitioners; and (5) creation of mechanism for exchanging information.

Occupational regulation is typically sought by members of a professional group. There is rarely pressure from the public to establish regulatory mechanisms in occupational areas. Proponents of regulation generally attempt to show the need to prevent incompetent individuals from practicing or to provide unknowledgeable consumers with information about capable practitioners. Regulation can, however, provide direct economic benefits to practitioners by limiting the number of individuals who may practice or imposing restrictions on the manner in which they may practice.

Since regulatory legislation has typically been enacted at the request of occupational groups, voices have been raised suggesting that there is a need for objective information about proposed regulation. A more responsible regulatory approach, it is argued, should be based on thorough analysis of direct and indirect costs and other effects, and consideration of optional approaches. An American Bar Association committee has suggested that a "burden of proof" be imposed on whoever wants to extend regulation into a new area. Specifically, proponents of regulation should be required to prove that the action would yield benefits greater than disadvantages.

Generally accepted criteria for the appropriate exercise of licensure authority are:

(1) Unqualified practice poses a serious risk to a consumer's life, health, safety or economic well-being.

(2) Such risks are likely to occur.

(3) The public cannot accurately judge a practitioner's qualifications.

(4) Benefits to the public clearly outweigh potential harmful effects of licensure (such as a decrease in the supply of practitioners).

Failure to meet these criteria, in general, indicates that licensure is not justified, or that some alternative form of regulation such as registration or certification, may be appropriate.

Requests for Licensure

Occupational and professional groups seek licensure for many reasons. It offers an opportunity for increased status for the practitioners, it is sometimes a prerequisite for third-party reimbursement, and it offers mechanisms for keeping unqualified or unscrupulous practitioners from engaging in the occupation or profession. Professional groups usually draft legislation providing for regulation of the profession and then attempt to convince legislators of the utility of that regulation.

The benefits of protecting the public from incompetent practitioners are not without negative side effects, however. Several pitfalls of occupational regulations are now recognized. Licensure laws frequently place restrictions on advertising and on various business structures and practices. By restricting the number of people entering a profession and the ability of new professions to work independently, licensure may increase the cost to consumers of some professional services. The mobility of practitioners has been hampered and in many fields, auxiliaries have been under used. Licensure often focuses on testing applicants for the initial license and is less concerned about the competence and performance of practitioners after the initial license is granted.

Several states have instituted formal processes for evaluating requests for regulation in an attempt to restrict licensure only to those occupations that meet the generally accepted criteria. These processes are referred to as sunrise processes and usually call for the requesting group to submit information to an executive branch office or legislative committee which reviews the information against a set of standards or criteria.

In Virginia, a commission within the Department of Commerce reviews such requests and makes a recommendation to the legislature. In Michigan, this responsibility is vested in the Health Occupations Council within the Department of Health. Illinois' legislature has a Select Joint Committee on Regulatory Reform, which reviews requests for regulating new professions.

The New York legislature has established a similar review process in the Assembly's Committee on Higher Education. A group requesting licensure must fill out an 18-item questionnaire before a bill to license a profession may be considered. The information received through the questionnaire is a basis for the committee decision regarding licensure. The process ensures that certain standardized information will be available to the committee.[6]

There are five methods by which states usually regulate occupations:

Private civil actions and criminal prosecutions: Whenever the State finds that existing laws are not sufficient to protect the public, it may provide by statute for more stringent causes for civil action and criminal prosecution.

Inspection: The activities and premises of persons in certain occupations are subject to periodic inspections to ensure that the public's health, safety and welfare are protected. An injunction can be issued to prevent persons who do not meet the standards from engaging in the occupation. Restaurant inspection is an example of this type of regulation.

Registration: Under this type of regulation, any person may engage in an occupation but he or she is required to submit information concerning the location, nature and operation of the practice.

Certification: As a form of regulation, certification recognizes persons who have met certain educational and experience standards to engage in an occupation. Although anyone may practice the occupation, only those who are certified may use the occupational title.

Licensure: Under this method of regulation, it is illegal for anyone to engage in an occupation without a license, and only persons who possess certain qualifications are licensed. Physicians are one of the occupational groups regulated by licensure.

Small businesses which are often opposed to regulation that emanates from governmental agencies is often the leading advocate of occupational regulation.

A Small Business Philosophy Toward Regulation

It is obviously difficult for the general citizenry to think regulation is as evil as small business persons voice, when these same interests can change and espouse regulation. Small business interests must be vigilant in opposing occupation licensing regulation unless there is a clear public threat. The philosophy of boarding the airplane and having the boarding ramp close behind you must eventually even hurt those who are on board. Indeed, once regulations keep people out of professions it is difficult to argue that those allowed in should not be severely regulated. In addition, it might be argued that the false security granted by exclusionary admission may backfire on the small firm. A "safe" environment represses innovation, flexibility and creativeness - these are the areas in which small firms have and must excel. Therefore rather than think occupational licensing is a blessing, small business people may do well to consider that all it may do is develop laziness and postpone the inevitable market test. I believe there are several things that a small business person can do to aid in a more realistic approach to occupational and professional licensing.

(1) Recognize that most regulations are the brain child of various special interest groups and that "turf" fights involve the public's turf.

(2) Recognize that regulations usually penalize the small. With less volume of operation, less lobbying clout and less of an information pipeline each regulation may well make the small enterprise less competitive with the large.

(3) Recognize that regulations usually lessen creativity. I often wonder that if there were a licensing procedure in place decades ago for inventors would Edison, Marconi or Bell have passed the licensing boards.

(4) Support legislation that requires citizen members on all professional boards.

(5) Support only these regulations that deal with probable adverse consequences on public health and safety rather than fantasized could be's.

(6) Recognize that the most innocent initial regulation once in place, has a way of inbreeding on itself and emerging as a real nightmare.

(7) Advance the view that government should provide only the minimum level of regulation.

(8) Recognize that protected status can only postpone, not eliminate, the eventuality of facing competition.

The strength of our economy lies in functional competition between various providers of services. No group should be exempt. Those who espouse unnecessary occupational licensing regulation will lessen the threat of free enterprise, the only environment in which dynamic small firms can function.

FOOTNOTES

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3. Deloitte, Haskins and Sells, "Small Business Paperwork Project," The Week in Review (February 8, 1980), p. 4.

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PRIVATIZATION OF PUBLIC SERVICES: A MODEL APPLIED TO URBAN TRANSIT

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Introduction

The authors approach the question of privatization from the perspective of certain basic propositions which are outlined in the abstract. Economic theory clearly recognizes a role for government intervention in markets ("regulation") and provision of public services such as mass transit. But there is barely a concrete doctrine of public production (government ownership and operation in lieu of private enterprise), as distinct from public production. This gap in economic theory reinforces our view that reliance should be placed on private production even within the context of public provision; and therefore on private-public cooperation where feasible.

The U.S. political economy is best characterized as a "mixed economy" regulated by a "fragmented polity." By a mixed economy, we mean that private and public elements are combined pragmatically in the national effort to maximize social welfare, promote efficiency and equity, and provide goods and services to consumers. The functioning of the U.S. economy is complicated, since important roles are properly allotted to governments and nonprofit institutions as well as business enterprises. The American polity is also complex in that it emphasizes fragmentation and decentralization through open and multiple access created by "separated institutions sharing powers,"[1] marble-cake federalism, and a policy-making process best envisioned as a "whirlpool" of interest-group partisanship functioning in each policy arena through the "iron triangle" of agencies, legislative subcommittees and organized constituencies.[2]

The American economic system has been described as being one of "regulated free enterprise."[3] "Free" is a misnomer, since it connotes not laissez-faire capitalism but rather private ownership and a presumption that the market mechanism should allocate social resources. However, prices and profits play this allocation role only within socially determined constraints. The market mechanism is regulated and subsidized for various purposes by elected governments, but is not "administered" through central economic planning or formal industrial policy. "Enterprise" implies reliance on profit-motivated entrepreneurship at all scales of business organization.

Despite the relatively long social tradition underlying the mixed economy and the fragmented polity, we lack a good theory of public enterprise, that is a theory of the public ownership and operation of economic activities.[4] The neoclassical theory "recognizes" a role for governments arising in business-cycle fluctuations, natural monopolies, imperfect markets, scale economies, externalities and public goods which force collective action; there is a role for nonprofit activities in demand variations.[5] These roles, however, justify public policy and even public provision of goods and services through involuntary tax payments. Ownership of assets, operation of enterprises, or provision of management services are quite different considerations, for which the conceptual basis is generally much more ad hoc in character.

The Transit Industry

The 1964 Urban Mass Transportation (UMT) Act contained explicit provisions for private enterprise in the mass transit industry (Sections 3(e) and 8(e)). Such policies were reiterated in the 1982 Surface Transportation Assistance Act (Section 9(f)); and in the 1984 draft UMTA policy on "Private Enterprise Participation in the Urban Mass Transportation Program." In essence, federal assistance was premised on private participation in local transportation planning; and on proper consideration of private-sector capacity for transportation service delivery. In practice, such provisions have been generally ignored at the state and local level.

Until 1964, mass transportation was largely provided by regulated, largely monopoly-franchise, enterprises which were privately owned and operated. After 1964, the industry was rapidly transformed into locally owned and operated public enterprises dependent on state-local and federal tax subsidy. The 1964 act required that federal assistance be provided only to public entities, with private firms explicitly excluded. Federal operating subsidies introduced in the 1974 Mass Transportation Assistance Act (Section 5 Urban Mass Transit Program) probably accelerated the national transit deficit.[6] The combination of public enterprise and tax subsidy was virtually guaranteed to increase deficits, focus on large-scale, radial-corridor bus and rail services, and exclude both private enterprise and paratransit modes--purely as organizational outcomes.[7]

Our research projects concluded that two major types of institutional barriers to privatization had been created by the 1964 UMT Act. The first barrier lay in the federal incentives, state legislation, and local administrative procedures which over two decades had been shaped around public enterprise on the one hand and the expectation of tax subsidy on the other hand.[8] The second barrier lay in two decades of exclusion of private enterprise and capital participation. As a result, the supply side of the market for private sources of transit investment funds is relatively fragmented and disorganized. Private investors and financial intermediaries have had little, and that largely haphazard, experience in the mass transit industry.[9] Private investment is therefore highly dependent on public policy stability and guaranteed profitability (whether through farebox revenues or public subsidy contracts).

Transit Theory and Practice

The "theory" underlying tax subsidy of publicly owned and operated transit enterprises is ad hoc at best. It is an amalgam of several disparate elements reflective of the political coalition supporting the present organizational and financing arrangements. Those elements may be summarized briefly as: (1) mobility access for the "transportation disadvantaged" (those economically unable to afford auto ownership) and the "transit dependent" (the elderly, handicapped or young); (2) a "balanced" transportation system to offset auto dominance in intrametropolitan travel; (3) relief of various external costs of auto usage, principally congestion, energy usage and pollution; and (4) reshaping urban land-use patterns through transit infrastructure.

We believe that the present organizational and financing arrangements for mass transit are best understood as the byproducts of public investment in auto usage in the post-1945 era. In 1960, 95% of transit systems in the U.S. were privately owned and operated utilities, usually franchised by local governments as a "natural monopoly" (despite modal competition from autos and paratransit); those systems employed only 64% of transit vehicles due to the heavy concentration (still true today) of ridership in New York and Chicago. Even in 1965, farebox revenues roughly covered total costs although deferred maintenance was widely practiced and impending bankruptcy was spreading. The 1964 UMT Act provided federal assistance for state-local takeover of private systems. In 1982, 44% of transit systems, 9% of vehicles, and 6% of transit trips were privately provided. Reorganization of the transit industry into public enterprises was followed by tax subsidy. In 1980, fares provided only 39% of operating revenues; state-local assistance 49%; and federal assistance 17%. During FY 1975-80, some $3.8 billion in operating assistance (peaking at $1.1 billion in 1981) and $817.7 million in capital assistance were provided by the federal government.

Most of the alleged reductions in external costs of auto travel resulting from mass transit other than mobility for the transportation disadvantaged and transit dependent may well not exist as a practical matter. In 1980, of work-related urban trips 6% (down from 9% in 1970) occurred by mass transit, 20% by paratransit, 60% by auto, and 10% by other modes. New rail systems probably compete with existing bus service (which handles 70% of transit trips). Energy, pollution and congestion are probably unaffected; city-shaping impacts are unknown because transit outside a few cities like New York and Chicago has only a marginal effect on regional accessibility. Paratransit handles much of the handicapped and elderly demand for travel. Mass transit attracts less than 3% of total urban trips at subsidized fares.

The subsidy to mass transit is high in both a relative and an absolute sense. In 1979 the average fare was 38¢ and the average subsidy was 67¢. The subsidy issue is largely bound up with equity questions; the debate here is not whether the subsidy is proper but only whether the subsidy policy in practice increases operating costs. Cervero estimates that operating cost-recovery fares of $1.05 would cut annual ridership 19% from 6.38 to 5.18 billion.[10] However, this high fare elasticity of mass transit demand suggests that much of the ridership loss would occur in smaller cities among marginal users with other options. Pucher concluded that affluent riders are differentially benefited by transit subsidy policy.[11] Mass transit ridership is heavily concentrated in a few major cities in the country, where fare and service elasticities are probably much lower than the average. Conceptually, subsidy of specific population groups could be handled by user-side voucher schemes or supply-side payments to competing private enterprises. Nothing in the policy objectives for mass transit dictates public ownership and operation as distinct from policy control and non-fare financing.

The Privatization Agenda

We have now developed the basic framework from which to tackle the question of privatization in the mass transit industry. "Privatization" is a poorly defined term at present. It came to popular attention as a "buzz-word" for the Reagan proposal to sell federal property and enterprises (viz TVA, Conrail, Amtrak, Dulles and National airports); and to replace social services with private charity.[12] The emphasis has thus been on changing from public to private control or ownership; as well as reducing tax expenditures by turning over presently public tasks to business enterprise.[13] Fiscal austerity and political ideology have been the driving motives for "privatization" at the state-local and federal levels, respectively. The mass transit case reveals that privatization should be more broadly understood, that it has a philosophical as distinct from an ideological basis and that private-public cooperation is a critical dimension of the privatization process.

1. The philosophical basis for privatization of the industry lies in the presumed advantages of private entrepreneurship and market competition over public bureaucracy under conditions of modal alternatives (mass transit, autos, paratransit) rather than natural monopoly (which might be more properly regulated as prior to 1964). Even if bureaucracies were equally efficient and effective in performance and cost, our social tradition would incline us to prefer competitive markets in a mixed economy. This tradition, however, clearly links deregulation with privatization, because monopoly franchise may exhibit few, if any, advantages over public monopoly. As a matter of principle, bureaucracies should exhibit marked advantages over private enterprise before they will be preferred; this condition may well exist for example in rail systems due to the

high fixed costs involved.[14] A large and increasing volume of studies in a variety of national and industry settings is asserting this perspective.[15] The usual rationale for public bureaucracy lies in market failure; since markets cannot or will not supply a particular commodity, private-public cost and performance comparisons are meaningless.

2. We argue that mass transit will not readily fit the standard rationales concerning public goods, natural monopoly, externalities, or scale economies. The intra-metropolitan transportation "market" is highly fragmented and variable (as marketers assert, there is never a "market" as such but a variety of market segments). Modal flexibility is warranted: such flexibility is more likely to emerge from competitive conditions through private entrepreneurship then from a public bureaucracy based on monopoly over rail and bus services. A demonstrated case for subsidy financing can be handled through user-side vouchers or contracting devices. The present organizational arrangements tend to stimulate radial rail-bus solutions on the traditional pattern.

3. Our study into "Administrative Impacts of Private Financing Techniques for Urban Transportation" conducted for U.S. DOT concluded that subsidy financing and the various provisions incorporated into the 1964 UMT Act had resulted in a situation of state-local dependence on public ownership and tax subsidies to the exclusion of alternative organizational arrangements, innovative financing possibilities, and private participation. The general range of financing and participation options is discussed in that report. The legal framework, administrative apparatus, and policy-making arenas for urban transportation at the federal, state and local levels have for two decades been oriented to the public enterprise-subsidy operation model accidentally created in the 1964 and 1974 legislation. One implication is a radical reorientation of federal subsidy guidelines toward efficiency and performance incentives.

4. We argue for the conceptual separation of the policy, financing, operation, management and ownership dimensions of urban transportation. The private-public cooperation questions can thus be tackled more fruitfully. For example, the Dallas regional transportation authority (DART) plans to contract all services to private entities. The authority will set policy and is funded by a one-cent sales tax. Other forms of private-public mixing are possible: assets can be publicly or privately owned and leased to the other sector; public enterprises can be managed by private companies; maintenance or other specified functions can be contracted; stations or other facilities may be privately provided or joint ventured. The mixing strategy can vary by function, service, corridor, asset type or geographical area. The principal barrier to mixing is the lack of experience with contracting and joint venturing that is characteristic of the traditional public services. But as Borcherding points out, perhaps 50% of public expenditures in the U.S. and Canada are handled on a contract basis through the private sector.[16]

5. The organizational alternatives need to be better understood. Costs and performance may well be affected by degree of competition, ownership structure, and organizational factors. In the mass transit industry, there are private and organizational alternatives to public-enterprise bureaucracy. Three basic organizational structures are possible: (1) the regulated firm or utility operating under a monopoly franchise (the general situation in the mass transit industry until 1964) and subjected to competing modes; (2) the public authority with a similar franchise and subjected to competing

modes (the present environment produced by the 1964 UMT Act); and (3) the private entrepreneurial firm competing for customers, capital and government contracts. The larger problem in which the transit financing and devolution issues are embedded is whether the current organizational form in the industry is the appropriate one. We regard the public-entity approach as an unintended consequence of the whirlpool policy-making process. Our evidence in support of this conclusion is the private-participation provisions of the 1964 UMT Act. Public ownership and operation of transit systems resulted from the restriction of financial subsidy to public entities. Privatization is in part a euphemism for altering the form of economic organization involved. Some of the rationale for privatization is based upon its incentive structure for motivating managers. It has been argued that as we move managers from the enterprise through the utility to the bureaucracy model, price-profit incentives are increasingly insulated from competitive pressures. Borcherding attributes this result to competition per se rather than to private property rights. Thus in the case of mass transit, fares are set administratively for political purposes and do not cover costs, which can be met out of tax revenues on a variety of subsidization arguments. We expect organizational outcomes to be those reported in studies of the transit industry: expansion of subsidized services to less cost-effective runs; focus on radial rail and bus solutions; reluctance to spin-off services, corridors or areas to private entities; and relative slackness in wage-benefit bargaining.

6. Our study into "Public vs. Private Ownership of Transit Systems" in part conducted interviews with many of the major New York City investment houses. In addition to administrative barriers created on the government side, private capital markets lack experience with investing in the mass transit industry. Yet that industry has many characteristics in common with the airline (regulated until 1978) and regulated utility industries. Heavy capital expenditures for fixed assets and equipment are involved, and prices have long been regulated. Capital acquisitions for airlines and public utilities are overwhelmingly managed through the private capital market by bank lending, equity issues, and bond issues.

> The principal factor in attracting private capital to any industry is the existence of a relatively acceptable risk-return opportunity. It is not important in theory whether the return is based on market earnings, regulatory fair rate-of-return, or tax subsidy (including contract); what is important is the expected rate of return given relative risk. External capital funding is always a form of "borrowing" (through credit or equity). Investor experience and a regularly functioning capital market help strengthen risk-return expectations. Experience conditions investors' willingness to accept an offered risk-return opportunity (i.e., a security). In the late nineteenth century, lacking significant experience with them, most investors considered the common stock of industrial firms to be excessively risky or speculative investments.

Summary and Conclusions

The transit industry has peculiarities which may make it particularly adaptable to the privatization agenda suggested. In general the paper argues that: (1) the U.S. political economy and social tradition embed a philosophical presumption in favor of markets functioning through private entrepreneurship, so that bureaucratic provision of commodities must in principle show advantages over market provision; (2) public-enterprise organization of the mass transit industry results from government investment in a competing mode (auto roadways) and the provision of financial subsidy only to publicly owned entities; (3) mass transit does not automatically meet the typical "public provision" tests of natural monopoly (arguing for regulated utility operation), public goods, externalities, or city-shaping infrastructure (although rail meets a scale-economy argument); (4) exclusion of private participation, rising transit deficits, and focus on relatively inflexible rail-bus sources are organizational outcomes to be expected from subsidized public authorities; and (5) the combination of public ownership/operation and tax subsidy has resulted in a variety of barriers to private involvement in the mass transit industry.

Privatization needs to be understood far more broadly than the specific program of federal-sector reductions, reallocations and devolutions proposed by the Reagan Administration; or as a substitute funding source imposed by recent state-local fiscal austerity. Separation of policy financing, operation, management and ownership dimensions of service provision permits us to see a much wider and richer range of privatization alternatives. The ultimate objective of privatization is not replacement of the public sector per se (which is a particular option in the privatization agenda), but the fostering of better private-public cooperation in a mixed economy and fragmented polity.

NOTES

1. Richard E. Neustadt, Presidential Power: The Politics of Leadership (New York: John Wiley, 1960), p. 33.

2. See Joseph L. Badaracco, Jr. and David B. Yoffie, "'Industrial Policy': It Can't Happen Here," Harvard Business Review 83 (6) (November-December 1983): pp. 96-105.

3. Ezra F. Vogel, "Guided Free Enterprise in Japan," Harvard Business Review 56 (3) May-June 1978: pp. 161-170. He distinguished U.S. "regulated free enterprise" from the Japanese system of "guided free enterprise."

4. An excellent exposition of the present doctrine is Ray Rees, Public Enterprise Economics (New York: St. Martin's Press, 1984 [2nd ed.]) which draws on the Continental, especially British, experience with nationalized pulic enterprise.

5. See Terry Moore, "Why Allow Planners To Do What They Do? A Justification From Economic Theory," Journal of the American Planning Association 44 (4) October 1978: pp. 387-398.

6. See Robert Cervero, "Effects of Operating Subsidies and Dedicated Funding on Transit Costs and Performances," Journal of Urban Analysis and Public Management 8 (1) June 1984: pp. 37-53; Don Pickring, "Rising Deficits and the Use of Transit Subsidies," Journal of Transport Economics and Policy 19 (3) September 1985: pp. 281-298.

7. Authors, "Administrative Impacts of Private Financing Techniques for Urban Transportation," Rice Center's Joint Center for Urban Mobility Research (Washington, DC: U.S. Dept. of Transportation, Research and Special Projects Administration, Office of University Research, January 1984), available through National Technical Information Service, DOT/RSPA/DMA-50/84/19.

8. Graham T. Allison, Essence of Decision: Explaining the Cuban Missile Crisis (Boston: Little, Brown, 1971). Allison distinguishes three models of decision-making in the federal executive branch: rational-actor, bureaucratic-politics, and governmental-process. Organizations are expected to develop "routines" (and we may add "doctrines").

9. Authors, "Public vs. Private Ownership of Transit Systems," Rice Center's Joint Center for Urban Mobility Research (Washington, DC: U.S. Dept. of Transportation, UMTA, University Research and Training Program, February 1986).

10. Robert Cervero, *Intergovernmental Responsibilities for Financing Public Transit Services* (Washington, DC: U.S. Dept. of Transportation, UMTA, August 1983), DOT-I-83-30, Tables 8.4 and 8.

11. John Pucher, "Equity in Transit Finance: Distribution of Transit Subsidy Benefits and Costs Among Income Classes," *Journal of the American Planning Association* 47 (4) October 1981: pp. 387-407.

12. Dale Russakoff, "Deficit Worries Bolster New Push for 'Privatization'," *The Washington Post* (January 13, 1986).

13. Janice Castro, "Public Service, Private Profits," *Time* (February 10, 1986): pp. 64-66.

14. But see Jose Gomez-Ibanez, "A Dark Side to Light Rail? The Experience of Three New Transit Systems," *Journal of the American Planning Association* 51 (3) Summer 1985: pp. 337-351; and Melvin Webber, "The BART experience: What Have We Learned?" *The Public Interest* no. 45 (Fall 1976): pp. 79-108.

15. See for example the studies cited in Harold Henderson, "Can Business Do It Better?" *Planning* 51 (11) November 1985: pp. 19-21; and especially Thomas E. Borcherding et al., "Comparing the Efficiency of Private and Public Production: The Evidence from Five Countries," *Zeitschrift fur Nationalokonomie/Journal of Economics* suppl. 2 (1982): pp. 127-156. Henderson properly cautions that much of the recent literature is ideological rather than empirical in tone. The empirical work evaluated by Borcherding will certainly support the general conclusion that bureaucracy exhibits no particular advantages. Borcherding emphasizes competition rather than ownership as the motivating factor in entrepreneurial innovation.

16. Borcherding, ibid., p. 144.

NATIONAL EMERGENCY AND PRIVATE PROPERTY RIGHTS: HISTORICAL RELATIONS AND PRESENT CONDITIONS

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The scope of private property rights in the United States has been greatly reduced during the twentieth century. Much of the reduction occurred episodically, as governmental officials seized control of economic affairs during national emergencies--mainly wars, depressions, and actual or threatened strikes in critical industries. The derogations from private property rights that occurred during national emergencies often remained when the crises passed. A "ratchet" took hold: people adjusted first their actions, then their beliefs, as they accommodated themselves to emergency governmental controls; later, lacking the previous degree of public support, private property rights failed to regain their pre-crisis scope.

How Emergencies Eroded Private Rights Historically

At the turn of the century, Americans enjoyed a wide scope of private property rights. The prevailing ideology of both elites and masses placed great importance on economic liberty. As James Bryce observed in *The American Commonwealth*, the typical American regarded the "right to the enjoyment of what he has earned" as "primordial and sacred," believing that all governmental authorities "ought to be strictly limited" and "the less of government the better."

Federal officials and judges typically acted in conformity with the belief that government ought to be confined to protective functions, refraining from redistributionist policies and leaving citizens free to conduct their economic affairs as they pleased. In *Allgeyer v. Louisiana* (1897) the Supreme Court declared that the Constitution protects "not only the right of the citizen to be free from physical restraint of his person, but . . . the right of the citizen to be free in the enjoyment of all his faculties; to be free to use them in all lawful ways; to live and work where he will; to earn his livelihood by any lawful calling; to pursue any livelihood or avocation, and for that purpose *to enter into all contracts* which may be proper, necessary, and essential *to his carrying out to a successful conclusion*" these purposes. When citizens were guaranteed such extensive freedom of contract, governments had neither much leeway to intervene in the market economy nor much reason to increase the burden of taxation.

In a violent break with American tradition, World War I witnessed the suppression of private property rights on a wide scale. In 1916 Congress granted the President emergency powers to seize materials, plants, and transport systems. During the war the government took over the railroad, ocean shipping, telephone, and telegraph industries; suspended the gold standard and controlled all international exchanges of goods and financial assets; commandeered hundreds of manufacturing plants; entered into massive economic enterprises on its own account in shipbuilding, wheat and sugar trading, and building construction; lent huge sums to businesses directly or indirectly; regulated the private issuance of securities; established official priorities for the use of transport facilities, food, fuel, and many other goods; fixed the prices of dozens of important commodities; intervened in hundreds of labor disputes; and conscripted nearly three million men into the army. In short, it extensively attenuated or destroyed private rights, creating what some contemporaries called "war socialism."

Although most private rights were restored after the war, not all were. Tax rates remained higher, the tax structure more "progressive," and the income tax became a much more important source of federal revenues relative to the traditional consumption taxes. The Transportation Act of 1920, by which the government relinquished its emergency control of the railroads, came close to nationalizing them. Government remained in the ocean shipping business. The War Finance Corporation episodically meddled in the credit markets until 1925. Most significantly, the war left a legacy of ideological change. As Bernard Baruch said in his memoirs *The Public Years*, the war experience convinced many prominent businessmen and others that "government direction of the economy need not be inefficient or undemocratic, and suggested that in time of danger it was imperative."

The next "time of danger" was not war but the Great Depression, a national catastrophe that Justice Brandeis called "an emergency more serious than war." After three years of widespread bankruptcies, foreclosures, and bank failures, of rapidly falling income and massively rising unemployment, it seemed the market economy would never recover. All classes of Americans grew increasingly clamorous for relief.

Recalling how the government had wielded sweeping emergency powers to manage the economy during the war, many politically influential people believed that similar governmental controls could prove effective in "fighting" the depression. (Their beliefs about the effectiveness of the wartime controls, we now know, were largely misapprehensions.) So in 1933 the government launched an entire fleet of emergency measures: huge work-relief projects; a program to cartelize all industries; abandonment of the gold standard and prohibition of private domestic transactions in gold; price and production controls in agriculture; detailed regulation of securities markets; extensive federal intrusion into labor markets and union-management relations; federal production and sale of electrical power; and, before the New Deal had spent itself in 1938, a multitude of federal insurance and credit programs, Social Security pensions and welfare payments, the minimum wage, national unemployment insurance, and many other forms of governmental intervention in the market economy.

For a while the Supreme Court resisted. The National Industrial Recovery Act and the first Agricultural Adjustment Act, centerpieces of the early New Deal, were declared unconstitutional. But the court was of two minds. In 1934 in the *Blaisdell* case it upheld a Minnesota mortgage moratorium law admitted by the state authorities to be, in normal times, an unconstitutional impairment of the obligation of contract; and in *Nebbia v. New York* it upheld an emergency state law fixing milk prices and punishing those who transacted at lower prices. In the *Norman* case (1935), sustaining the government's abrogation of the gold standard, the court put private contractual rights in a clearly inferior position: "There is no constitutional ground for denying to the Congress the power expressly to prohibit and invalidate contracts although previously made, and valid when made, when they interfere with the carrying out of the policy it is free to adopt." Finally, in 1937, the court caved in completely. Since then it has maintained that virtually any governmental interference with private property rights is constitutional.

The justices were only registering the ideological transformation going on around them. The Great Depression deeply discredited longstanding beliefs in individualism, private property rights, free markets, and limited government. The New Deal gave desperate people money and jobs, for which they were grateful. More importantly it taught many people, including a new generation of Americans who had no personal experience with anything else, to value collectivist policies and governmental promises of economic security.

Drawing on the collectivist programs and sentiments of World War I and the New Deal, the government during World War II built an unprecedented apparatus of economic control. The authorities drafted ten million men for service in the armed forces, allocated strategic materials, established priorities for the use of transport, food, fuel, and other goods, commandeered plants and sometimes whole industries, fixed prices and rents, rationed many consumer goods, built and operated entire new industries. In short, the free market virtually disappeared during 1942-1945.

While private property rights were being suppressed across the board, the Supreme Court just smiled. As Clinton Rossiter once said, "the Court, too, likes to win wars." Even when the government herded some 110,000 persons of Japanese descent, two-thirds of them U.S. citizens, into concentration camps, the court stood aside, declaring the peremptory imprisonment of these innocent persons "in the crisis of war" to be "not wholly beyond the limits of the Constitution." (Where, one wonders, are the constitutional limits on governmental invasion of private rights during emergencies?) In World War II not even the most elementary private rights could withstand the government's determination to exercise emergency powers.

Enduring legacies of the war included the Employment Act of 1946, committing the federal government to a policy of ongoing macroeconomic management, the Taft-Hartley Act of 1947, preserving many of the federal powers first stipulated in the War Labor Disputes Act of 1943, and the Selective Service Act of 1948, extending into peacetime the military conscription by which the government had coercively obtained the bulk of its military manpower at below-market rates during the war. Most significantly, as Calvin Hoover observed in *The Economy, Liberty, and the State*, the war experience "conditioned [businessmen] to accept a degree of governmental intervention and control after the war which they had deeply resented prior to it." Even under the pro-business Eisenhower administration, no serious attempt was made to overthrow the economic controls inherited from past emergencies.

How Emergency Powers Continue to be Exercised

Until the late 1970's, unrevoked presidential declarations of national emergency continued to sustain extraordinary governmental authority. As late as 1976 the emergency declared by Roosevelt in 1933 had not been terminated. Truman's 1950 declaration remained operative as years, then decades, passed. Even when political conditions in the United States became as "normal" as possible in the nuclear age, the government continued to use a fictitious emergency rationale to augment its statutory power.

Few people worried about the emergency-spawned powers until the Nixon years. To deal with the 1970 balance-of-payments "crisis," Nixon declared two more national emergencies. They also remained unrevoked. Only when the Watergate escapade and the impoundment of congressionally authorized funds engendered widespread fear of an imperial presidency did Congress begin to investigate seriously the web of governmental controls spun on the pillars of unrevoked executive declarations of national emergency.

In 1973 the Senate created a Special Committee on the Termination of the National Emergency to investigate the emergency powers. Finding that four presidential declarations of national emergency remained in effect, the committee reported:

> These proclamations give force to 470 provisions of Federal law . . . [These] powers, taken together, confer enough authority to rule the country without reference to normal constitutional procedures. Under the powers delegated by these statutes, the President may: seize property; organize and control the means of production; seize commodities; assign military forces abroad; institute martial law; seize and control all transportation and communication; regulate the operation of private enterprise; restrict travel; and, in a plethora of particular ways, control the lives of all American citizens.

The committee's work led to enactment of two significant statutes, the National Emergencies Act (NEA) of 1976 and the International Emergency Economic Powers Act (IEEPA) of 1977.

The NEA sought to reassert congressional control over burgeoning national emergency legislation. Terminating all existing national emergencies two years after its enactment, the act permits future presidential declarations of national emergency only under strict procedures guaranteeing periodic executive and congressional review of each emergency decree. The act also stipulates that statutory authority contingent on a state of emergency cannot be triggered by a national emergency decree unless the President specifically states his intent to exercise authority under that particular statute. Moreover, the act declares that national emergencies may be terminated by concurrent resolution of Congress as well as by presidential proclamation or automatic lapse if not renewed annually by the President.

As originally enacted the NEA exempted Section 5(b) of the Trading with the Enemy Act (TWEA) from its provisions. The exemption was significant because the TWEA had, since 1917, given the President virtually unlimited power during war or (since 1933) national emergency to regulate or prohibit foreign exchange or international credit transactions. To narrow the exemption, Congress passed the IEEPA. In effect, the IEEPA separates pressidential power over transactions previously covered by Section 5(b) into two categories. The TWEA is amended to authorize presidential action only during war, while the IEEPA becomes a repository for executive economic power wielded during other emergencies. The IEEPA also restricts the emergency powers to apply to international transactions only. Withheld are the purely domestic emergency powers previously exercised under the all-inclusive TWEA.

Although the President's emergency authority over international transactions retained its previous scope, the power to effect the requisite emergency was narrowed. By repealing the exemption that had shielded Section 5(b) of the TWEA from the NEA, Congress guaranteed that future declarations of national emergency within its scope would be subject to the NEA and that current "emergencies" could be terminated as specified in that statute. However, existing uses of Section 5(b) powers continued to be insulated from the NEA by provisions enabling the President to extend current Section 5(b) programs annually upon executive determination that such extension "is in the national interest"--that is, without the necessity of a continuing national emergency.

How well have the NEA and the IEEPA served their intended purpose? In the nearly ten years since their enactment the attempted curtailment of executive emergency power has proved to be much less successful than the statutory language suggested it would be. The dramatic and frequent use of executive emergency power that persists under the NEA and IEEPA speaks for itself. Presidents Carter and Reagan have declared national emergencies repeatedly to impose sweeping economic restrictions on Americans dealing with the citizens of other nations: Iran, Nicaragua, South Africa, and Libya, to name a few. Most recently, invoking the NEA and the IEEPA, President Reagan declared a national emergency to rationalize a complete prohibition of the economic activities of Americans in Libya and ordered all U.S. citizens residing in Libya to leave or face criminal sanctions. Also under claim of national emergency, President Reagan recently used the IEEPA to keep in force an important law, the Export Administration Act, for over a year after Congress had allowed it to expire.

The Supreme Court has helped to keep the President's emergency economic powers free of congressional hindrance. In 1983 the court ruled in *Immigration and Naturalization Service v. Chadha* (the "congressional veto" case) that Congress cannot use a concurrent resolution, or any other method short of full constitutional requirements for enactment of legislation, to overturn a decision delegated to the President, thus by implication invalidating one of the NEA's restraints on presidential use of emergency authority. In Dames & Moore v. Regan (1981) the court gave broad construction to the President's power to act under the IEEPA.

But the greatest erosion of the NEA and the IEEPA came in Regan v. Wald (1984). At issue was the scope of the "grandfather" provision of the IEEPA, which exempts "existing uses" of Section 5(b) powers from the NEA's restrictions. Despite lawmakers' deletion from the grandfather provision of language that would have explicitly shielded from the NEA not only existing regulations but any changes in rules applicable to the regulated subject, the Supreme Court ruled that the grandfather provision *does* encompass changes in existing restrictions if they pertain to the same general "authority" previously exercised under the TWEA--that is, the court held that the act authorizes exactly what the congressmen had been assured in hearings that it would not authorize. The immediate result of the court's decision was that a major new curtailment of private travel to Cuba was implemented under the Cuban Assets Control Regulations without the necessity of declaring a national emergency or complying with the procedures of the NEA. The long-run implication is that, with the stroke of a judicial pen, an apparent pinprick in the NEA's armor against abuse of emergency powers has become a gaping hole.

Conclusion

Private property rights, historically truncated during national emergencies, remain highly attenuated and vulnerable to further erosion in future crises. Attempts to restrain the abuse of emergency powers have not eliminated the ratcheting effect of actual or purported emergency in augmenting governmental power. Only the respite of noncrisis affords time to contemplate and forestall the threat to liberty and private property rights inherent in the emergency psychology of the public and its exploitation by governmental officials.

LESSONS FROM THE REDLINING DEBATE

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For over a decade now government, academicians, and public interest groups have studied the redlining phenomenon and the lessons distilled from this varied and extensive analysis should be of immediate interest to anyone concerned with the morality of competitive private enterprise. Redlining is the alleged practice of discriminating in mortgage lending on the basis of race, gender or some other proscribed variable, especially the quality of the neighborhood in which the property to be mortgaged is located.

This paper is an attempt to derive and elucidate these lessons as well as develop their implications with respect to private enterprise. The central truth or fundamental lesson is that, given competition, market forces will prevent discrimination more effectively than any number of laws and regulations however strictly enforced.

THE PRIVATIZATION OF PRISONS: AN OVERVIEW

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The decade from 1975 to the present has witnessed political, economic and sociological changes that have had a profound impact on the kinds and levels of services provided by government and on the methods by which they are delivered.

Politically, Americans began to question the traditional role of government as the "steward of the public welfare." This changing political philosophy, coupled with increasing demands by the electorate for conservatism, has created a renewed emphasis on contracting with private firms to deliver services traditionally supervised and performed by government employees.

This movement toward privatization is predicated on certain basic assumptions: (1) government is inherently bureaucratic, which inevitably raises costs; (2) public sector employee unions bid wages above market rates; and (3) private firms are more cost conscious because of the profit motive. Privatization is an attractive alternative since it is projected to be both economic and efficient--two characteristics considered synonymous with good government. Politically, privatization is responsive to the calls to "get government off the backs of the people."

Concurrent with these political and economic trends, a new phenomenon was also unfolding: a dramatic rise in the number of prisoners in state and federal correctional facilities, from 396,000 in 1982 to a currently estimated 500,000 (the number rose from 166,000 in 1950).

Faced with demands for more stringent sentencing policies and unable to gain voter approval of bond issues to enlarge existing prisons or build new ones, states housed prisoners in existing facilities regardless of the resulting overcrowding. This solution was invalidated by U.S. Supreme Court findings that overcroweded prisons constituted "cruel and unusual punishment."

To meet the perceived need for additional facilities at lower costs, a private corrections industry is developing. Operations range from managing juvenile detention centers to offering $250 million to lease and operate the Tennessee state prison system.

The emerging private correctional institutions are not without critics and potential pitfalls: (1) the uniqueness of the corrections function may not make it amenable to privatization; (2) the constitutionality of non-government entities incarcerating prisoners is questionable; (3) the legal liability of state and local governments has not been determined; (4) the ability to provide oversight of private prisons must be analyzed; and (5) the possible conflict of interest between incarceration and profit maximization has yet to be considered.

The trend toward private prisons has been described as ". . . the major unexamined social policy of the 1980's." Existing research relates primarily to privatization experience with juvenile facilities and alien detention centers, not with maximum security facilities.

Rather than recklessly proceeding into uncharted areas, it is recommended that: (1) a moratorium be declared on all new private prisons to allow for further analysis of their long-term impact; (2) alternatives to imprisonment be investigated; (3) attempts should be made to revise current procedures and work rules in public sector institutions to promote more efficient operations.

STUDENT-TEACHER CHARACTERISTICS AND ECONOMIC LITERACY: A MIDDLE GRADE STUDY

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The purposes of this study were two. The first was to determine to what extent children from one grade level were learning basic economic concepts as a result of their teachers' in-service activity and general preparedness. The second purpose was to identify socio-economic, demographic and attitudinal factors which might also contribute to the children's knowledge of economics.

The variables examined in this study have been individually analyzed over many years by various authors.[1] Here, however, our inquiry measured the combined effects of several independent factors. It was our belief that if specific characteristics emerged as more important than another, or if several factors demonstrate equal importance, then researchers can begin to study the most effective way to deliver economic education.

COLLECTION OF THE DATA

The experimental group consisted of all sixth grade pupils from two North Carolina counties (McDowell and Iredell).[2] During the early part of the 1983-84 school year, the children from these two school districts sat for the Basic Economics Test (BET), Form A.[3] The score from this test served as the primary measure of the child's knowledge, understanding, and application of basic economic concepts. Additionally, each child was given a questionnaire to complete which yielded demographic attitudinal information.

A second survey instrument was developed and circulated to all fifth and sixth grade teachers in both school systems. The instructors were asked to provide information about their students' socio-economic background by estimating each child's family income and the highest academic level attained by that individual's parent(s). The questionnaire also sought to detail the extent of the instructor's own economic training and the time spent teaching economics or social studies in the classroom. Data were collected from the 17 McDowell County teachers and the 28 Iredell County instructors, providing 555 and 766 observations respectively.

DATA ANALYSIS

Between Counties and with the National Norm

Out of a possible 38 points, the average raw score for all sixth grade children from McDowell and Iredell counties was 16.93 and 18.54 respectively. The scores between the two school districts were statistically significant at the 0.001 level. Selecting the McDowell County sixth graders as the "base" group, an adjustment factor for Iredell County children was then developed to correct for inequalities between basic aptitude and the acquisition of economic knowledge. The new score for Iredell County pupils was reduced to 16.65. The adjusted score difference of .28, however, was not statistically significant.

In comparing the scores of the students in North Carolina to those scores used in the norming of the BET, children from both North Carolina counties score significantly below the pupils in the national group. Iredell County pupils' average of 18.54 and McDowell County pupils' average of 16.93 were far below the national average of 20.29. However, there may be several possible explanations for these differences. Eighty percent of the students in the norming sample were believed to belong to upper or middle-class families. This figure would be somewhat lower for both Iredell and McDowell counties. Thus, if family status is a factor in the learning process, the test scores for the children in the two North Carolina school systems would be biased downward. Also, the BET was given to the pupils sitting for the norming sample at the end of the school year. Our examination was administered during the early part of the academic year. Finally, in neither North Carolina county are there any large metropolitan communities. Indeed, both areas could be characterized as rural. A more meaningful evaluation can be made here by comparing the individual North Carolina county scores with the rural community category average test score of the norming sample. The average score for rural communities was 18.37. Iredell County, it will be recalled, showed an unadjusted score of 18.54, slightly above the national norm. McDowell County's score remained at 16.93.

Individual Characteristics: Between Counties and Among Categories

The major thrust of the study, however, was to investigate the influence of the child's inherent abilities, family background and the extent his teacher's preparedness on his economic cognition. Hence, we disaggregated the data by student and teacher characteristics and test scores; the test values were then compared between the counties as well as within each county. The findings were striking. As Tables 1 and 2 clearly indicate, pupils in Iredell County once again outscored their counterparts in McDowell County for most categories studied. What is of greater interest, however, is the comparison of test scores among given categories. Regardless of the county under investigation, there is a positive correlation between such socio-economic variables as a student's family income or the educational attainment of his parent(s) and that child's test score (Table 1). This is true regardless of the county being examined. Parents who enjoy status and position due to their academic achievements or earning power will often be perceived as role models to be emulated by their children.

Table 1

A Comparison of Unadjusted Basic Economic Test Scores by Family Vacation, Family Income, Family Education, Sex and Race: Student Characteristics

	McDowell County		Iredell County	
Category:	$\bar{X}$	S.D.	$\bar{X}$	S.D.
Family Travel:				
Often	17.35	5.70	19.31	6.07
Sometimes	16.63	5.73	18.15	6.63
Never	16.00	5.62	15.44	6.13
Family Income:				
Less than \$5,000	14.66	5.58	14.27	6.55
Between \$5,000-\$15,000	16.25	5.70	18.08	6.51
Greater Than \$15,000	18.11	5.54	19.13	6.20
Family Education:				
Less than 8th grade	12.85	4.90	16.36	6.81
8th-11th grade	14.29	5.34	16.95	6.57
High School	17.73	5.32	18.32	6.30
Some College	18.89	5.84	20.92	5.87
Sex:				
Male	16.94	6.17	18.18	6.34
Female	16.91	5.16	19.04	6.42
Race:				
White	17.01	5.74	19.15	6.29
Black	15.82	5.24	15.47	6.00

Furthermore, in most categories reported, there is a direct relationship between the amount of teacher preparedness and the student's test score (Table 2). This is particularly true in Iredell County. The only exception to this observation is the number of economics courses that teachers had successfully completed in college. These findings are of considerable interest to all economic educators who wonder if participants in economic education workshops, summer institutes, or special economics programs are using the knowledge they assimilated in these exercises to improve the economic expertise of their own students. Although far from being absolutely conclusive, the data do lean toward affirmation of this position.

Table 2

A Comparison of Unadjusted Basic Economic Test Scores by College Preparation, Employment Preparation and Instructional Time: Teacher Characteristic

	McDowell County		Iredell County	
Category:	$\bar{X}$	S.D.	$\bar{X}$	S.D.
College Preparation:				
Social Studies Courses 18 or more semester hours	17.11	5.49	19.72	7.29
Economic Courses:				
0-1 Course	16.81	5.70	18.90	6.67
2-3 Courses	17.88	5.54	17.96	5.84
4-5 Courses	15.74[a]	4.57	18.26	6.15
Employment Preparation:				
Economic In-Service				
0 hours	16.59	5.67	17.52	7.02
1-10 hours	17.35	5.57	18.35	6.34
11+ hours	17.02	5.69	20.24	6.32
Instructional Time:				
Percent Teaching Social Studies				
0-10	18.40[b]	6.52	17.48	5.98
11-15	17.28	6.51	17.81	6.01
16-20	17.12	5.25	20.31	5.71
21 +	18.28[c]	4.92	18.45[d]	6.49
Instructional Time:				
Percent Teaching Economics: (as part of Social Studies)				
0-5	17.35	6.21	18.96[e]	5.09
6-10	16.83	5.91	18.57	5.23
11-20	17.46	5.23	18.31	6.45
20 +	-----	----	19.08	5.36
Hours Teaching Economics:				
10-25	19.94	6.21	16.74	5.64
26-50	16.81[f]	5.62	-----	----
County Average	18.54	6.41	16.92	5.71

[a] N=21 (one class)
[b] N=64 (two classes)
[c] N=53 (two classes)
[d] N=29 (one class)
[e] N=23 (one class)
[f] N=149 (five classes)

McDowell County, The Norming Sample and Pre- and Post-Testing

To investigate the effect of teacher in-service and the extent of economic education in the classroom on the child's comprehension of basic economics, the researchers selected one school system for study. McDowell County, which had demonstrated the lowest relative unadjusted test score on Form A of the BET was selected.

After the pre-test (Form A of the BET) was administered in October 1983, additional in-service training was provided to all sixth grade teachers in McDowell County. Near the end of the school year, a post-test (Form B of the BET) was given to measure the change in the student's performance. Two stages of the study developed. First, we focused on the scores attained by the children who sat for the norming of the national test, Form B. In particular, we examined those categories designated as, "with instuction" and "with 13 plus weeks instruction." The comparison of McDowell County Students with the national sample was dramatic. For the two categories under investigation, scores of 20.01 and 23.43 were recorded by the North Carolina pupils; whereas, results of 19.76 and 22.00 were reported for the national group. However, only the latter category was statistically significant at the 0.07 level.

Next, we compared the pre- and post-test scores of McDowell County children separately. Again, the findings were impressive. Table 3 illustrates a statistically significant increase in the average test scores for every characteristic shown (at the 0.05 level).

Table 3

A Comparison Between the Pre- and Post-Basic Economic Test Scores:
Student Characteristics
McDowell County

Student Characteristics:	Form A		Form B	
	$\bar{X}$	S.D.	$\bar{X}$	S.D.
Sex:				
Male	16.94	6.17	21.54	6.39
Female	16.91	5.16	21.64	5.94
Race:				
White	17.01	5.74	21.74	6.13
Black	15.82	5.24	18.72	6.26
Family Travel:				
Never	17.35	5.70	19.24	6.98
Sometimes	16.63	5.73	20.67	6.02
Often	16.00	5.59	22.76	6.10
Family Income:				
Less than $5,000	14.66	5.58	17.44	6.84
Between $5,000-$15,000	16.25	5.70	20.52	5.81
Greater than $15,000	18.11	5.54	23.33	6.02
Family Education:				
Less than 8th grade	12.85	4.90	17.35	5.94
8th-11th Grade	14.29	5.34	19.17	6.02
High School	17.73	5.32	21.57	5.86
Some College	18.89	5.84	25.00	5.52

Furthermore, a pattern identical to one witnessed earlier (Table 1) had again emerged. There was a positive correlation between student scores and various socio-economic characteristics. Table 4 also yielded information that supports the hypothesis that children can learn economics if given the opportunity. For the vast majority of teacher characteristics which purport to measure instructor preparedness, student scores rose significantly when their teacher "responded affirmatively." Indeed, for the vast majority of teacher characteristics, there was a profound and usually significant increase in test scores both between and among the various categories.

Table 4

A Comparison Between the Pre- and Post-Basic Economic Test Scores:
Teacher Characteristics
McDowell County

Teacher Characteristics:	Form A		Form B	
	$\bar{X}$	S.D.	$\bar{X}$	S.D.
Social Studies:				
18 or more semester hours	17.11	5.49	21.96	6.34
Economics:				
0-1 Courses	16.81	5.70	21.93	5.97
2-3 Courses	17.88	5.54	19.55[e]	5.10
4-5 Courses	15.74[e]	4.57	16.87	5.92[c]
Employment Preparation:				
Economics in-service				
0 Hours	16.59	5.67	-----	-----
1-10 Hours	17.35	5.57	22.35	6.27
11+ Hours	17.02	5.69	21.14	6.11
In Class Instruction:				
% Teaching Social Studies				
0-10 Percent	18.40[a]	6.52	18.30[d]	5.91
11-15 Percent	17.28	6.15	20.78	6.34
16-20 Percent	17.12	5.25	21.78	5.77
21+ Percent	18.28[b]	4.92	23.50	6.01
%Teaching Economics (When Social Studies is being taught)				
0-5 Percent	17.35	6.21	21.17	5.57
6-10 Percent	16.83	5.91	19.44	5.64
11-20 Percent	17.46	5.23	21.04	5.50
21+ Percent	-----	----	23.00	5.86
Hours Teaching Economics:				
10-25 Hours	16.74	5.64	20.01	5.55
26-50 Hours	-----	----	23.43	5.61
County Average:	16.92	5.71	21.59	6.18

[a] N=21 (one class)
[b] N=64 (two classes)
[c] N=30 (one class)
[d] N=23 (one class)
[e] N=27 (one class)

It is apparent from the change in the pre- and post-test scores that there was a marked improvement in the extent of student knowledge, understanding and application of basic economic concepts. Some of the explanation for the increase could be found in the teacher's willingness to prepare herself for teaching economics and from the amount of class time she devoted to the delivery of that subject. This is apparent from Table 4. To pursue this belief further the authors chose to compare the extent of teacher preparedness by measuring the extent of preparation of the child's sixth grade teacher (from whom much of his learning of economics is reflected in the test results of Form B), with those of his fifth grade teacher (those instructors who contributed much to his understanding of economics as indicated by the test results earned from Form A). Table 5 reports the comparisons.

Table 5

A Comparison of the Average Amount of Training and Classroom Delivery Between 5th and 6th Grade Teachers

	5th Grade Teacher		6th Grade Teacher	
Category	$\bar{X}$	S.D.	$\bar{X}$	S.D.
Semester hours earned in Economics	2.83	3.26	1.79	2.01
Average Number of In-Service Hours in Economics	8.71	6.73	14.00	6.89
Average % of Time Spent Teaching Social Studies	18.88	6.23	20.00	9.08
Average % Teaching Economics (when Social Studies is being taught)	14.41	6.34	17.70	9.08
Hours Spent Teaching Economics	17.06	7.72	27.90	18.37
	N=17		N=16	

With the exception of only one category shown (Semester Hours Earned in Economics), the sixth grade teachers "out-performed" their fifth grade colleagues. For example, additional in-service training obtained during the academic year plus economics education acquired in previous periods rose by over five percentage points for the sixth grade teachers. Further there was more time spent teaching economics in the latter grades in both absolute and percentage terms. However reflective these figures are, caution does appear to be in order. They do not take into account intangibles. That is, each teacher was aware of the fact that her class was to sit for a post-test at the end of the school year. It is reasonable, therefore, to assume that this awareness contributed to some increase in the intensity of instruction.

Another factor which probably plays a role in the in-class delivery of economic subject matter lies in the timing of the workshops given. In-service offered during the summer months does not carry the same timeliness as in-service offered during the school year. Teachers who receive instruction useful for the teaching of economics are generally eager to disseminate the information received as quickly as possible. Such is probably not the case of continuing education provided when school is not in session. With respect to the pre-test, much of the in-service for classroom teachers was provided during the summer months. For those students sitting for the post-tests, their teachers were given additional training during the school year.

The point to be made is straightforward: given the fact that teachers were aware of an impending examination and given the belief that in-service has a more immediate effect if offered during the school year, teachers, both consciously and unconsciously, probably intensified their instruction of economics to some degree. How much of an increase from the "norm" is unknown. Nonetheless, much of the evidence given does suggest that given the opportunity middle grade children can learn economics.

Differences Among McDowell Schools

One more test was performed to analyze statistical differences among the test scores for the eight McDowell County schools. A Duncan Analysis of Variance test yielded two distinct school groupings of four each. Although we found a range between the highest average score and the lowest average score of 3.293 for schools in the first group, there emerged no statistical difference among the four institutions. The same statement can be made for schools in the second set. However, and most importantly, we did find a statistical difference between the two groups.

There is an explanation that might suggest a reason for the difference between the two groups of McDowell County schools. Of the eight middle grade schools, their schools taught social studies in a "blocking" fashion with one instuctor in each school given the sole responsibility for the teaching of social studies throughout the institution. Of the schools which employ this method of instruction, all are in the high test score group. Clearly, eight schools are much too small a "sample" to provide any definitive conclusions. The suggestion, nonetheless, remains noteworthy and points to a fruitful field for further research.

Summary

The evidence examined throughout the paper supports the fact that given specific advantages, pupils can achieve higher levels of economic learning. Teachers who are better equipped as the result of in-service training and other measures of preparedness train students who possess superior levels of economics cognition. Furthermore, the data suggest that clear and identifiable student characteristics influence student scores on standardized tests.

END NOTES

1. See: William B. Walstad, "The Impact of 'Trade Offs' and Teacher Training on Economic Understanding and Attitudes, "The Journal of Economic Education, 1980, pp. 41-48; Harry I. Greenfield, "Economics in Secondary Schools: Some Problems of In-service Teaching Social Studies," The Social Studies, 1982, pp. 217-219; Howard M. Schober, "The Effects of In-service Training on Participating Teachers and Students in Their Economics Classes," The Journal of Economic Education, 1984, pp. 282-295; and also William A. Luker, "DEEP Revisited," The Journal of Economic Education, 1984, pp. 111-118.

2. Both counties are located in the mountainous western part of North Carolina and are similar in their limited economic base and population size (approximately 35,000 persons.)

3. See: John F. Chizmar and Ronald S. Halinski, Basic Economics Test-Examiners' Manual, Joint Council on Economic Education, New York, NY, Checklist Number 297.

NATIONAL SURVEY OF HIGH SCHOOL ECONOMICS

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INTRODUCTION

Considerable interest has been shown in economic education during the past 15 years. Recently, however, that interest seems to have reached new heights. The Teacher Education Committee of the Joint Council on Economic

Education recommended in December that all "perspective elementary and secondary school teachers should be required to take at least one economics course and preferably the entire principles sequence."[1]

According to a recent publication entitled, *Excellence in Economic Education: A Survey of State Mandates for Economics Instruction, 1985-86*, twenty-seven states currently have some form of mandated economic education. Twenty-four states have free enterprise-economic education mandates, four states require that high schools make economics available to students as an elective, ten have consumer education mandates and seven have both free enterprise education and consumer education mandates. Fifteen states require at least a semester course (1/2 unit) in economics for high school graduation.[2]

Even though numerous mandates exist and economics is taught in various degrees, very little is known about the nature and extent of economic education. The purpose of this study was to determine the content thought important by the teachers of economics and to determine the type of text utilized.

METHOD

During the summer of 1985, with funding from a faculty research grant at The University of Tennessee at Martin, a questionnaire was mailed to a random sample of high schools in each state. There were a total of 1,000 questionnaires mailed. Except in Tennessee, a proportionate number of questionnaires were mailed to each state. If a state contained 2% of the population in the United States it received 2% of the questionnaires. A larger sample was taken in Tennessee in order to study the individual state. A total of 173 questionnaires were returned.

Respondents were asked to answer a number of questions related to high school economics offered at their school. Questions ranging from whether or not economics is taught, to rating the importance of economic concepts in the course, were included. Responses to selected questions, along with comparative results between the midsouth region and the remainder of the nation, are reported in this paper. The midsouth region is defined in this study as Alabama, Arkansas, Georgia, Kentucky, Louisiana, Mississippi, Missouri, and Tennessee.

RESULTS

General Results

When asked if high school economics was offered, 17 or 10% of the 173 respondents indicated that it was not. Two of these respondents were from the midsouth region and fifteen from the nation, excluding the midsouth.

All respondents, except 12, indicated that economics was offered as a separate course. Those 12 indicated that economics was included in such courses as consumer economics (3), government (3), free enterprise (3), computer literacy (1), introduction to business (1), and sociology (1).

Twenty-one respondents indicated that a full year of economics was offered while eight indicated that less than one-half year was offered. All other respondents indicated that one-half year was offered.

Economic Content Results

Respondents were asked to indicate the degree of importance which they place on a number of economic concepts. The highest ranking respondents could give to a concept was a number five, which would indicate it was considered very important. The lowest ranking would be a number one, which would indicate it was considered relatively unimportant. The results of that ranking are presented in Table 1.

Table 1

RANK ORDER OF ECONOMIC CONCEPTS
FOR NATION, NATION EXCLUDING MIDSOUTH AND MIDSOUTH

TOPIC	NATION		NATION EXCLUDING MIDSOUTH		MIDSOUTH	
	%	Rank	%	Rank	%	Rank
Supply & Demand	93	1	96	1	91	2
Markets & Prices	88	2	84	2	93	1
Inflation/Deflation	81	3	81	5	82	5
Competition & Mkt. Struct.	80	4	83	3	77	8
Role of Government	79	5	76	7	82	4
Productivity	79	6	76	9	84	3
Scarcity	78	7	81	4	81	6
Economic Systems	77	8	76	8	78	7
Opportunity Costs	73	9	74	10	72	9
Monetary Policy	73	10	78	6	67	11
Gross Nat'l Product	68	11	71	11	65	13
Exchange, Money & Interdependence	67	12	66	13	67	10
Economic Institutions & Incentives	67	13	69	12	64	14
Consumer Economics	61	14	64	15	58	16
Unemployment	59	15	54	16	66	12
Fiscal Policy	58	16	64	14	51	18
Income Distribution	52	17	44	19	61	15
Aggregate Supply	49	18	45	17	54	17
Aggregate Demand	45	19	44	18	47	19
Absolute & Comparative Adv., Barriers to Trade	36	20	37	21	35	21
Market Failures	35	21	29	23	43	20
Internat'l Growth & Stab.	34	22	38	20	29	22
Bal. of Pay. & Exch. Rates	30	23	35	22	25	23

Rank Order Comparison

To allow comparison beween the midsouth schools and the rest of the nation's schools the results are given in percentages and by rank order. To determine the ranking of the relative importance of the various economic concepts the percentages of responses ranking a concept 5 or 4 were added together. For example, nationally, 70% of the teachers gave the concept of supply and demand a rating of 5 and 23 percent gave it a rating of 4, thus 93% of the teachers considered it relatively "very important." In ranking the concepts from 1 through 23 the highest percentage of "very important" ratings (those responses indicating 5 or 4) was given the rank of one. The results are reported by percentage and by rank order for the national survey in columns one and two. Columns three and four contain data from all states other than the midsouth, and columns five and six contain data from the midsouth region.

Nationally, supply and demand were ranked first with 93% of the teachers giving it a "very important" rating. The concept of markets and prices was ranked second with 88% of the teachers rating it "very important." In some cases two different concepts had the same percentage rating. This is the situation where the concept of economic institutions and incentives and the concept of exchange, money and interdependence were both given a "very important" rating by 67% of the teachers nationally. For ranking purposes, the tie was broken by going to the percentage of teachers giving each of the concepts a rating of 5. The concept of exchange, money and interdependence was given a rating of 5 by 27% of the teachers and the concept of economic institutions and incentives was given a rating of 5 by 25% of the teachers. This resulted in exchange, money and interdependence having a rank of 12 and the concept of economic institutions and incentives having a rank of 13.

Based on these ratings some general observations can be made. The concepts of supply and demand and the concepts of markets and prices are rated at the top of the concepts considered to be "very important" in both the midsouth and rest of the nation. Although the percentage of teachers rating them as "very important" have some differences the concepts of international economics are ranked near the bottom throughout the country. These are the concepts of basis of trade (absolute and comparative advantage), international monetary movements (balance of payments and exchange rates), and relative international welfare (international growth and stability). Given the importance of international trade to our nation today, it is to be hoped these topics can receive additional emphasis in the future.

The ratings of the relative importance of the various economic concepts may be due to several factors. It may reflect the composition of courses taken in graduate or undergraduate school when the teachers were attending. Currently popular topics, such as inflation and productivity, enjoy a relatively high rating. Some standard topics retain their popularity while others are relatively low ranked. These include supply and demand and markets and prices which are right at the top, and then such standard concepts as income distribution and market failures which are ranked relatively low. One explanation of the relatively low ranking of the international topics is the order of the treatment of these concepts in most text books. They are usually toward the back of the book. It is probable that such relatively new topics as aggregate supply and aggregate demand are in the process of moving up in the ratings since they are becoming more generally used. Probably for multiple reasons, there are regional differences in the ratings of some concepts by teachers.

Major Differences

There is a 10% or greater difference in the number of teachers giving each of the concepts listed in Table 2 a "very important" rating between the midsouth and the rest of the nation.

Table 2

MAJOR DIFFERENCE IN IMPORTANCE PLACED ON
ECONOMIC CONCEPTS BETWEEN NATION (EXCLUDING MIDSOUTH) AND THE MIDSOUTH

TOPIC	NATION EXCLUDING MIDSOUTH	MIDSOUTH
Income Distribution	44%	61%
Market Failures	29%	43%
Fiscal Policy	64%	51%
Unemployment	54%	66%
Bal. of Payments & Exchange Rates	35%	25%

In three of these concepts (income distribution, market failures, and unemployment) the greater emphasis is given in the midsouth. Greater emphasis is given to the concepts of fiscal policy and balance of payments and exchange rates in the rest of the nation than in the midsouth.

In four other concepts there is a 9% difference in the percentage of teachers rating the concepts as "very important." In the nation, excluding the midsouth, a greater emphasis is placed on the concepts of monetary policy (78% vs. 67%) and international aspects of growth and stability (38% vs. 29%) than in the midsouth. The midsouth places a greater emphasis (in percentage of teachers rating the concepts as "very important") on the concepts of markets and prices (93% vs. 84%) and aggregate supply (54% vs. 45%) than in the nation excluding the midsouth.

Table 3

RANK ORDER OF TEXTBOOKS USED IN HIGH SCHOOL ECONOMICS FOR NATION COMPARED TO NATION (EXCLUDING MIDSOUTH), AND MIDSOUTH

NAME OF TEXT	NATION TOTAL		NATION EXCLUDING MIDSOUTH		MIDSOUTH	
	%	Rank	%	Rank	%	Rank
ECONOMICS: PRINCIPLES AND PRACTICES, Merrill Co.	23.2	1	17.5	1	30.0	1
ECONOMICS TODAY AND TOMORROW Harper and Row Co.	16.4	2	11.3	2	22.5	2
ECONOMICS: THE SCIENCE OF COST, BENEFIT, AND CHOICE South-Western Co.	7.9	3	2.1	12	15.0	3
THE AMERICAN ECONOMY: ANALYSIS, ISSUES, PRINCIPLES Houghton-Mifflin Co.	5.6	4	7.2	3	3.8	5
INVITATION TO ECONOMICS Scott, Foresman Co.	5.1	5	6.2	4	3.8	5
ECONOMICS OF OUR FREE ENTERPRISE SYSTEM, McGraw Hill Co.	4.5	6	6.2	4	2.5	7
FREE ENTERPRISE-THE AMERICAN ECONOMIC SYSTEM	4.5	6	6.2	4	2.5	7
ECONOMICS: PRINCIPLES AND APPLICATIONS, Kennedy	4.5	6	2.1	12	7.5	4
THE STUDY OF ECONOMICS: PRINCIPLES CONCEPTS, AND APPLICATIONS Dushkin Publishing Group	4.0	9	5.2	8	2.5	7
PRINCIPLES OF ECONOMICS South-Western Co.	3.4	10	6.2	4		
APPLIED ECONOMICS	2.8	11	3.1	9	2.5	2
CONSUMER ECONOMIC PROBLEMS	1.7	12	3.1	9		
ECONOMICS FOR EVERYBODY	1.7	12	2.1	12	1.3	13
THE ECONOMIC PROBLEM	1.7	12	3.1	9		
FUNDAMENTALS OF THE AMERICAN FREE ENTERPRISE SYSTEM	1.7	12	1.0	17	2.5	7
CONSUMER ACTION	1.1	16			2.5	7
ECONOMICS, D. C. Heath & Co.	1.1	16	2.1	12		
ESSENTIALS OF ECONOMICS & FREE ENTERPRISE, Addison-Wesley	1.1	16	2.5	7		
THE WORLDLY PHILOSOPHERS	1.1	16	2.1	12		
CONSUMER CHOICE, Houghton	0.6	20	1.0	17		
CONSUMER DECISION MAKING	0.6	20	1.0	17		
CONSUMERS IN THE ECONOMY	0.6	20	1.0	17		
DOLLARS AND SENSE	0.6	20	1.0	17		
ECONOMICS, Paul Samuelson	0.6	20	1.0	17		
ECONOMICS: ANALYTICAL APPROACH	0.6	20	1.0	17		
ECONOMICS-INSTITUTIONS-ANALYSIS Hutell	0.6	20	1.0	17		
ECONOMICS: MEETING PEOPLES NEEDS	0.6	20	1.0	17		
FREE ENTERPRISE IN THE U.S,	0.6	20	1.3	13		
HARD CHOICES, Stearling	0.6	20	1.0	17		
MANAGING YOUR PERSONAL FINANCE Joan Ryan	0.6	20	1.0	17		
THE WORLD OF ECONOMICS Silk & Saunders	0.6	20	1.0	17		

Textbook Results

Table 3 illustrates the results of the ranking of the textbook, by the economics teachers in the nation, the nation excluding the midsouth and the midsouth region. The nation and the midsouth were consistant in its ranking of the first two textbooks: Economics: Principles and Practices by Clayton and Economics Today and Tomorrow by Miller.

There is a great deal of diversity in the ranking beyond the rank of number two. For instance, Economics: The Science of Cost, Benefit and Choice is ranked number 3 in the nation and the midsouth, yet it falls to number 12 in the nation, excluding midsouth. As one would expect there was a greater diversity of textbooks adopted in the nation excluding the midsouth (28) than in the midsouth (15). A total of 31 textbooks were listed. It is interesting to note in Table 4 that 5 of the 31 textbooks used contained the term "Free Enterprise" in the title, while 6 contained the term "Consumer" or "Personal Finance." The percentage of texts with "Free Enterprise" in the title was greater (11.3% for the nation) than for the percentage of texts with "Consumer" or "Personal Finance" in the title (5.3%).

Table 4

PERCENTAGES OF TEXTS WITH "FREE ENTERPRISE," "CONSUMER,"
AND "PERSONAL FINANCE" IN THE TITLE FOR THE
NATION, THE NATION EXCLUDING THE MIDSOUTH, AND THE MIDSOUTH

	NATION	NATION EXCLUDING MIDSOUTH	MIDSOUTH
TEXTS WITH "FREE ENTERPRISE" IN THE TITLE (5)	11.3%	12.5%	13.2%
TEXTS WITH "CONSUMER" OR "PERSONAL FINANCE" IN THE TITLE (6)	5.3%	10.0%	

Summary

Economics is a popular subject in the high school curriculum, either by mandate or by local choice. The results of this study indicate the following:

1. Economics is generally offered in high school as a separate course for one-half year.
2. The concepts of supply and demand and concepts of markets and price are ranked high as very important in the nation.
3. Concepts related to international economics are rated very low.
4. Teachers in the midsouth differ with the rest of the nation on the degree of importance placed on income distribution, market failures, fiscal policy, unemployment, balance of payments and exchange rates in high school economics.
5. There is a wide variety of economics textbooks used in high school economics.

It would be interesting to duplicate this study on the same or a larger scale in another two or three years to determine changes which will occur. The authors have received indications that the study will be replicated in another country soon. Economic education cannot help but benefit from such comparative studies.

NOTES

1. Economic Education for Future Elementary and Secondary Teachers: Basic Recommendations, Joint Council on Economic Education, New York, NY, December, 1985.

2. A Survey of State Mandates for Economic Instruction, 1985-1986, Dennis C. Brennan, Joint Council on Economic Education, New York, NY, JCEE Checklist No. 360.

A PRACTICAL INTEGRATION OF SUPPLY-SIDE ECONOMICS WITH IS-LM FOR INTERMEDIATE LEVEL STUDENTS

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University of Texas at Arlington

Context

The standard IS-LM presentation at the intermediate level is not well-suited for analysis of the expanded dimensions of macroeconomic problems that have emerged over the past two decades. Upper level courses in the subject can overcome this deficiency through a systematic development of aggregate supply concepts or, alternatively, through a more fashionable approach than the still frequently-encountered IS-LM (Hicks-Hansen) interpretation of Keynes.

At the intermediate level, class time is first needed to review sophomore concepts and--later--to add international relationships to IS-LM. Once this and IS-LM have been covered, 20% or less of the semester remains. In this limited time, any method is welcome that can usefully link IS-LM with aggregate supply, prices, productivity, capacity problems and growth. The method suggested here is a selective assembly of well-known concepts and procedures of macroeconomics into a classroom presentation the author has used for the past decade with some possible success as a learning device. As a preachment, it is not "high mass." Rather it is rough-and-ready missionary work among the darkest wilds of an undergraduate business school classroom.

Assumptions

With the semester 80% complete, students should be reasonably proficient with a basic IS-LM model that includes proportional taxes and money velocity, as well as net exports of both goods and services and of financial liquidity (Figure 1). They have traced the impact upon equilibrium income and interest rates of each possible autonomous disturbance. They have further considered the reality of all autonomous disturbances occurring continually, with constantly-moving IS and LM curves (equilibrium as a "path" rather than a "point"). Given the relationship between equilibrium income (Ye) and an arbitrary income target (Yf) that represents "effective full capacity," students can evaluate the propriety of any given demand-driven fiscal and/or monetary policy in a Keynesian world.

Method

First, IS-LM is deflated by an appropriate price index and an aggregate demand curve is derived *via* an explanation of Keynes and Pigou effects (Figure 2). A Keynesian demand-side view of the world, as well as the nature of demand-biased macroeconomics fiscal and monetary policies, can be placed in historical context and illustrated by appropriate shifts in aggregate demand.

Second, a single micro market model is used to distinguish between the effects of an increase in demand--*case #1*--(analagous to demand-pull inflation at the macro level) and a *decrease* in supply--*case #2*--(analagous to cost-push inflation at the macro level) (Figure 3). With credit to Wicksell, an analogy is suggested between price and quantity equilibrium in the micro market and a macro-context equilibrium expressed by an equilibrium index of all prices and an equilibrium real income (Ye/P) (Figure 4). Careful explanation draws a parallel between the possible vertical portion of the micro supply curve and "effective full capacity" (Yf/P) of a given aggregate supply curve in order to introduce students to the conditions of "pure" inflation (Figure 5).

Third, scenarios of possible supply curve shifts are developed carefully in both a micro and a macro context. To this point in the course, students have only considered the impacts of changes in investment and government spending upon the demand side of the economy (Ye/P), the linkage being the multipliers. With reference to Harrod/Domar, students are next introduced to the "dual nature of investment spending," with its impacts also on "effective full capacity income" (Yf/P) (Figure 6). The supply-side linkage between changes in investment or government purchases depends not only upon the quantity of capital formation but its quality, also--Harrod/Domar's "widening" of capital versus "deepening" of capital. In a micro context, "widening" of capital is more likely to produce only modest shifts in a firm's supply curve and may, when combined with recession, price controls or escalating input costs (such as that of primary energy), generate net supply shifts to the left and produce cost-push inflation (Figure 7). Such events are not efficiently offset by policies of aggregate demand management conceived in a "Phillips curve" world that may ignore the crucial interdependence between shifts in aggregate demand and resulting shifts in aggregate supply curves.

Finally, a reasonable macroeconomic goal is suggested: shift aggregate supply rightward at a speed commensurate with technical growth possibilities and concurrently manage aggregate demand growth at the same rate. The result should be maximum possible real growth at stable prices. With reference to Harrod/Domar, possible qualitative differences between private sector investment spending and government purchases can finally be explored and a possible minimal impact of government transfer payments upon a deepening of capital can be suggested.

At this point, students can discuss the fundamental differences between Keynesian, Supply-side and Monetarist views of the economy in a fairly efficient manner. The class can evaluate the growth and inflationary potential of various types of spending, along with the implications of treating cost-push inflation as if it were demand-pull in nature. Other scenarios, such as the supply-side impact of a fall in energy costs (both offset by a tax hike and otherwise) can be accomplished within this framework, depending upon remaining semester time.

Conclusion

Although admittedly informal, this approach does allow for fairly efficient class analysis beyond basic IS-LM procedures and is particularly appropriate for business students whose exposure to formal economics education, both before and after this intermediate course, is usually quite limited.

FIGURE 1

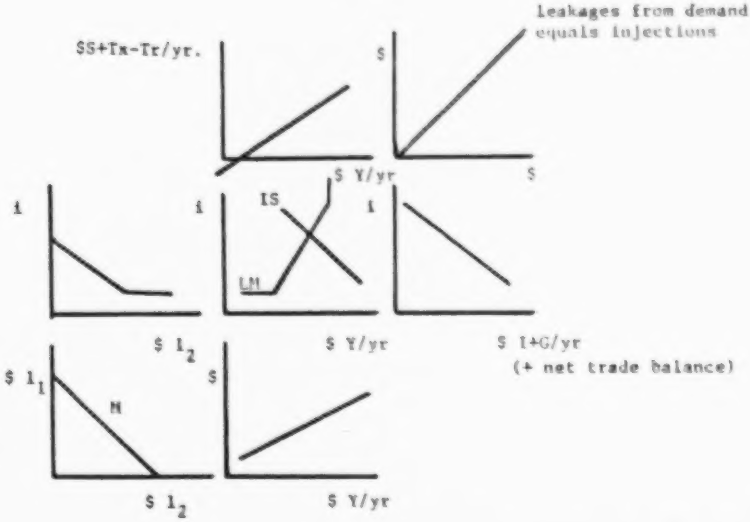


FIGURE 2

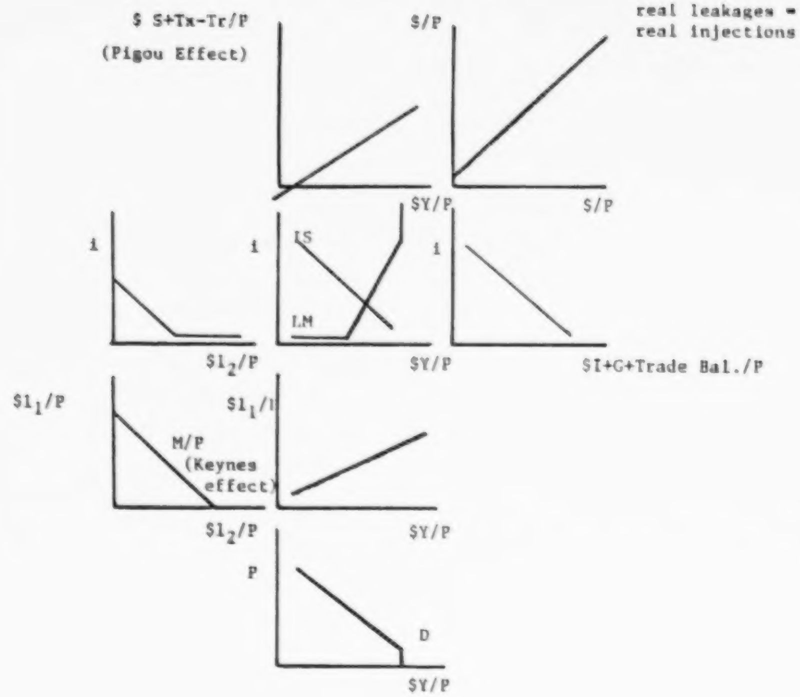
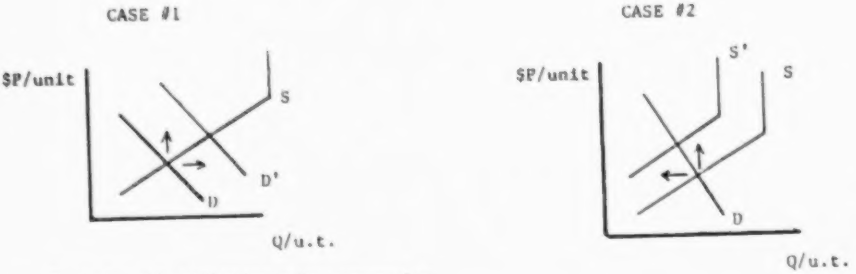

$ S+Tx-Tr/P
(Pigou Effect)
$/P
real leakages = real injections
$Y/P
$/P
i
i
i
IS
LM
l_2$/P
$Y/P
$I+G+Trade Bal./P
l_1$/P
l_1$/P
M/P (Keynes effect)
l_2$/P
$Y/P
P
D
$Y/P

FIGURE 3

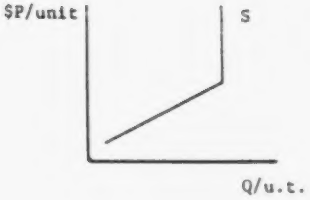
--A SINGLE MICRO MARKET--


CASE #1
$P/unit
S
D'
D
Q/u.t.
CASE #2
$P/unit
S'
S
D
Q/u.t.

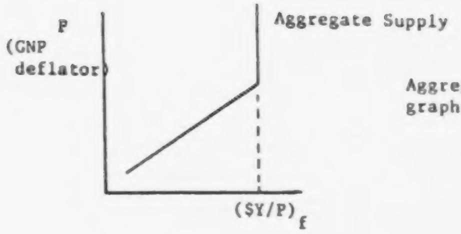
Demand-pull inflation plus expansion

Cost-push inflation plus recession

FIGURE 4



A Single Micro-market



Aggregate Demand-Aggregate Supply graph of IS-LM

FIGURE 5

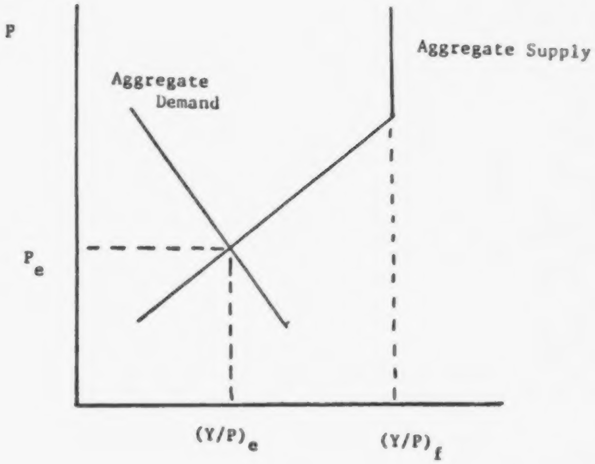
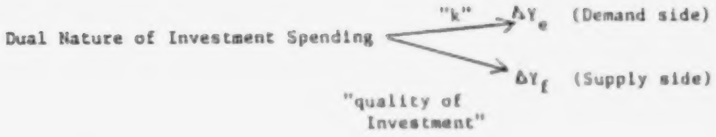


FIGURE 6


Dual Nature of Investment Spending
"k"
ΔY_e (Demand side)
ΔY_f (Supply side)
"quality of Investment"

--A Single Micro Firm--

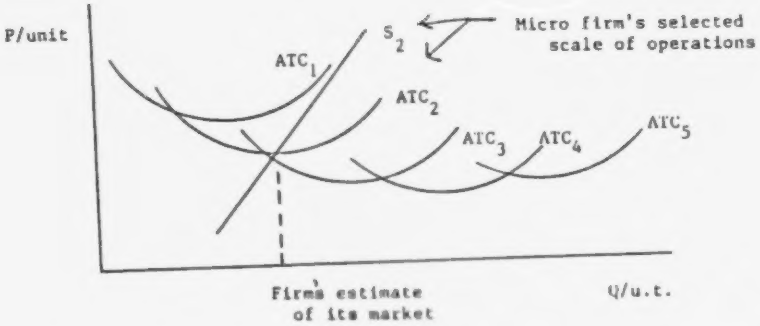
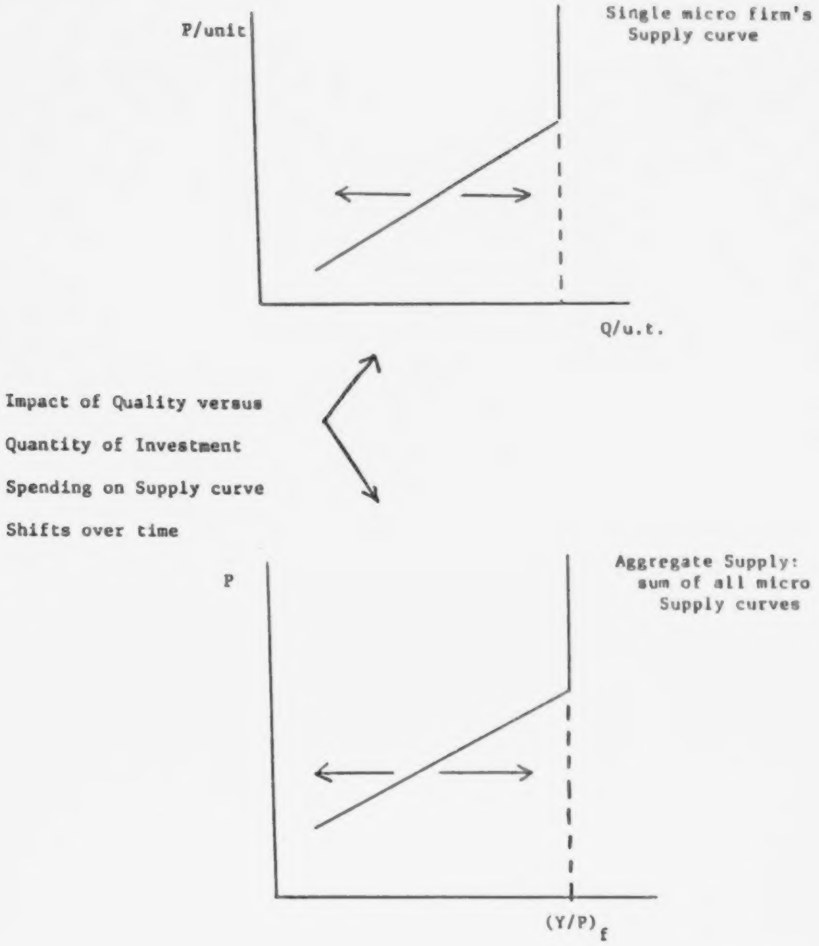

P/unit
S_2
Micro firm's selected scale of operations
ATC_1
ATC_2
ATC_3
ATC_4
ATC_5
Firm's estimate of its market
Q/u.t.

FIGURE 7



P/unit
Single micro firm's Supply curve
Q/u.t.
Impact of Quality versus Quantity of Investment Spending on Supply curve Shifts over time
P
Aggregate Supply: sum of all micro Supply curves
$(Y/P)_f$

A LESSON IN INTERNATIONAL ECONOMICS

Saul Z. Barr
The University of Tennessee at Martin

The Life of David Ricardo (1772-1823)

David Ricardo was born in London, one of seventeen children to a wealthy stockbroker who fled the religious persecution of Spain. David Ricardo was formally schooled only until he reached the age of 14. David Ricardo, like many other great economists, was a rebellious youth. All the other classical economists, save Adam Smith who never saw his father, rebelled against their parents. He was not unlike John Stuart Mill and Rev. Thomas Malthus in his break with his father and family. Ricardo gave up the Jewish religion of his family and married a young Quaker. By the age of 21 he was such a successful broker of government securities that by the age of 40 he had earned such a fortune that it allowed him to retire as a country gentleman in Scotland.

The boredom of retirement drove him to publish his famous PRINCIPLES OF POLITICAL ECONOMY AND TAXATION in April 1817. Here he wrote about laissez-faire economics and said, ". . .wages. . .like all other contracts. . . should be left to the fair and free competition of the market, and should never be controlled by the interference of the legislature." Writing followed with a career in the House of Commons of the English Parliament where he spoke out fervently against, ". . .the public debt and restraints on free trade." (Spiegel, 1971, p. 311).

Ricardo served in Parliament during the last five years of his life. He died in his early 50's and left an estate estimated at 700,000 pounds which today would be approximately $20 million. Certainly Ricardo proved he understood trade and exchange.

Ricardo's Original Lesson in International Trade and Exchange

Ricardo's Theory of Comparative Advantage is simple but strong in its message for free trade and exchange. Suppose we measured the value of goods based upon the hours needed to produce them. Further, suppose England and Portugal were considering engaging in international trade. Would it be to the benefit of only one trade partner or both if they did trade? The answer lies in Ricardo's own table below:

	Number of Laborers Required To Produce Specified Units of	
	Cloth	Wine
Before Trade:		
England - One Unit Each	100	120
Portugal - One Unit Each	90	80
After Trade:		
England - Two Units of Cloth	200	
Portugal - Two Units of Wine		160

His table shows simply that if each nation tried to produce both cloth and wine, England would have to use 220 units of labor and Portugal 170 units of labor for every set of one unit of each. If each nation specialized in one output, say England cloth and Portugal wine, both nations would save labor time tremendously. With only 200 hours England could produce each two units of cloth while Portugal could produce each two units of wine with only 160 hours of labor. The same level of output could be achieved with 20 less labor hours in England and 10 less labor hours in Portugal.

The power of this lesson is that before trade England was less efficient than Portugal but free trade of goods between the two countries increased the wealth of both nations. England had no absolute advantage in production but gained along with Portugal in a free exchange of products. Both cloth and wine needed more labor time in England than in Portugal. England, however, had a comparative advantage in cloth over wine because England could produce it more efficiently per unit than wine. Portugal, on the other hand, had absolute advantages in both outputs and a comparative advantage in wine. When free trade was used both nations benefited because they could produce the same amounts together with each using fewer labor hours.

The advantages, of course, continue. If England uses as much labor time as they did before trade as does Portugal then together they can produce more than ever before. If efficiency and specialization lead to increases in efficiency as well then these increases will just be a beginning. In Ricardo's own words, "(free trade) increase(s) the mass of commodities, and therefore the sum of enjoyments."

United States and International Trade

The forces to limit free trade both domestically and internationally are known by all. Consumers fear high prices if domestic goods are exported. Foreigners may be willing to pay more for our goods than we do. Producers, on the other hand, fear increased competition from imports. Producers know that producers elsewhere may be more efficient than they are and fear they could not compete. It seems when some start loosing jobs from import competition that the mass hysteria usually leads to trade restrictions.

Certainly we produce fewer automobiles while imported cars flood our market and certainly the price of bread is higher because we export so many metric tons of grain. When these facts are assembled it is easy to see why we, along with many newspapers and magazines, miss the point Ricardo had made so clearly. If each nation produces what it produces best by their comparative advantage, both nations would become better off even if one nation is less efficient in everything than its trade partner.

Even if we produce fewer items that can be imported as England stopped producing wine and raise the price of our items that are exported as the price of cloth did rise in Ricardo's example that does not mean the "sum of enjoyments" and the welfare of the nation falls. Even though we may sell fewer, for example, cars, we would be able to produce much more, for example, wheat and together with our trade partners produce more wheat and cars for both of us. We would increase the sum of enjoyments by increasing the aggregate amount of production both over here and over there and make a larger number of commodities available for all. Unfortunately even though the sum of the gains made by the gainers exceeds the sum of losses by the losers in free trade it does not mean the gainers will have their way. Trade continues to be restricted with every passing dilemma.

Summary

Of course Ricardo's example is greatly simplified compared to what traders actually face. Labor is certainly one of the factors of production and there are many other costs involved. A nation does not face a transition from one production to another so easily. Ricardo felt strongly that free trade and exchange is best for us even if our trading partner is more efficient in everything we produce. This is what makes the Ricardian Theory of comparative advantage so timeless. Ricardo wrote, "Under a system of perfectly free commerce, each country naturally devotes its capital and labor to such enjoyments as are most beneficial to each. The pursuit of individual advantage is admirably connected with the universal good of the whole. . .By increasing the general mass of production it diffuses general benefit, and binds together by one common tie of interest and intercourse the universal society of nations throughout the civilized world."

Ricardo saw free trade as the glue that would bind the world rather than a force that would slow economic growth. It is no wonder Ricardo died a wealthy man.

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Note: This lesson is intended as a handout for classes in undergraduate economics.

ENTREPRENEURSHIP--THE DIFFERENCE BETWEEN ECONOMIC SYSTEMS--MAN'S MATERIAL PROGRESS

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Economy is defined as the social institution that facilitates the production and distribution of goods and services. There are two basic approaches to the distribution: distributing it according to need (Marxism), or based on the principle of exchange (free enterprise system).

The Marxist approach is based on the "zero sum" principle, which follows Marx's labor theory of value: "only labor creates value, and profit is stealing." The free enterprise system is based on the "positive sum" approach, which follows the Marginal Utility Theory and the Austrian School's approach to value: value is subjective, and exchange DOES create value.

The thesis of the paper is that the entrepreneur who facilitates the exchange is entitled to a share of the surplus value that is created because of the exchange. The share is called "profit."

To the extent that entrepreneurship is crucial to economic progress, profit is the incentive that leads to a progressive economy. The different level of entrepreneurship explains the difference between a stagnating and a progressive economy.

To illustrate the importance of entrepreneurship, the formula MAN'S MATERIAL WELFARE = NATURAL RESOURCES + HUMAN ENERGY X TOOLS (MMW = NR + HE X T), developed by THE AMERICAN ECONOMIC FOUNDATION is taken one step further by adding ENTREPRENEURSHIP (E) as an exponential of T.

E is defined as ENTREPRENEURSHIP equals INVESTMENT times OPPORTUNITY times PROFIT PROSPECT (E = i x op x p). The new formula will be MAN'S MATERIAL PROGRESS equals NATURAL RESOURCES plus HUMAN ENERGY times TOOLS raised to ENTREPRENEURSHIP level ($MMP = NR + HE \times T^E$).

According to this formula, the usefulness of tools depends on E, which is determined by availability of investment, opportunity to invest, and prospect of making a profit. If any of these is zero, E will be zero, and tools will remain idle. If E = 1, tools will be used at their minimum potential. To get the most out of the tools, E has to be greater than one.

Thus, the difference between economic systems can be traced to different definitions of value and consequently to different practices in promoting or discouraging entrepreneurship by different investment policies, opportunities and profit prospects.

This explains not only the basic differences between the USSR and the US, but also can serve as a guide for the developing countries if they want to have a prosperous economy.

UNCERTAINTY AND PLANNING FAILURE

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Bryant College

The purpose of this paper is to identify a methodological source of planning failure and to point out the inadequacy of the traditional tool for planning economic activities.

Most economists in constructing their models have implicitly assumed that there is no vagueness in human thinking. In reality, this is not true. There exists fuzziness in the process of scanning environmental conditions, identifying policy alternatives, and evaluating potential outcomes. Furthermore, a decision-maker is more interested in an approximate solution rather than the precise optimality.

Knight distinguished uncertainty from risk. If the probability associated with each state of nature can be identified, it is a situation under risk; otherwise, under uncertainty. Traditionally, if the probability of occurance of a given state is unknown, a subjective probability is assigned. Thus, economic models often treat uncertainty as risk. This is related to randomness while uncertainty is associated with both randomness and fuzziness. It is important to note that randomness is caused by changes in objective environment and fuzziness has its root in subjective judgements. Zadeh has pointed out that subjective probability is not a good measure of fuzziness. He thus proposes the use of the fuzzy set concept.

The incorporation of fuzzy set concept in economic modeling requires the use of fuzzy-random distribution. The ignorance of such distribution in econometrics is perhaps one of the primary reasons for the lack of accuracy and reliability of economic forecasts.

The use of fuzzy inference signifies a methodological deviation from mechanistic modeling. Economics, following the pattern of methodological development of physics, progresses from mechanistic modeling with determinism, through mechanistic modeling with randomness, to non-mechanistic modeling with indeterminism.

The existence of vagueness in human thinking requires economists to modify some of their fundamental concepts. With fuzzy-random distribution, for instance, it is more appropriate to use the concepts of demand and supply "strips," not "curves." Conceptually, if price of an item is used as a control variable for changing quantity demanded, a planner must know the "threshold" of price adjustment for reaching the targeted quantity. Without knowing the "thresholds" of these control variables, no effective manipulation of human behavior should be expected.

The employment of fuzzy-random analysis supports the claim that there is "economics without equilibrium." If economists insist that there is such a thing called equilibrium, then it is a fuzzy "area," not a precisely defined "point." For this reason, the use of traditional equilibrium concept could also lead to planning failure.

COMPARING STATE SUPPORT OF HIGHER EDUCATION

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Mississippi State University

and

Dorothy Anderson
The University of Tennessee

Many studies have concentrated on states' needs for programs offered by Institutions of Higher Education (IHE), and the manner in which these needs can be met and financed. Until the mid-1970s the usual objective of these studies was to discover "soft spots" in the existing tax structure so that new taxes would be most readily accepted by taxpayers. This was brought to an end by the tax revolt period of 1978-1980 which saw 19 states enact tax or expenditure limitation legislation by 1984. In addition, in June 1980 Congress voted to eliminate the states' portion of federal revenue sharing. With no countercyclical assistance from Washington the recession of 1981-1983 saw large tax increases at the state level to offset the recession-induced revenue losses.

State support of IHE has followed this same rags to riches pattern of state tax collections, with the smallest increase in over 20 years from fiscal 1983 to 1984 and increasing thereafter. Almost without exception, a state's search for the solution to the above problem leads to a key question: Where do we rate in comparison with other states? The interest of state officials, legislators, school administrators, and others is highlighted by this concern with comparative performance.

Each fall the National Association of State Universities and Land Grant Colleges publishes the results of an annual survey by the late Professor M. M. Chambers, commonly called the Chambers Report. The Chambers Report provides timely and up-to-date information on appropriations of state tax funds for annual operating expenses to public and private universities and colleges across the country. For example, the fiscal 1985-1986 data was published not far from the end of the first quarter of the fiscal year. The appropriations data, in addition to direct support of public and private IHE, includes appropriations for state scholarships or other student financial aid. They do not include sums intended for capital expenditures or debt service. Nor do they include money from federal or local taxes and student fees. The sums, of necessity, do not include supplementary appropriations of other changes made later in the fiscal year. Professor Chambers writes, "The top priority is to make the data available in this timely publication, at the end of the first quarter of the fiscal year in most states."

Each fall The Chronicle of Higher Education takes the results of the Chambers Report and ranks the states according to total appropriations for higher education, appropriations per capita, and appropriations per $1,000 of state personal income. For example, the analysis for 1985-1986 shows that Mississippi (the poorest state in the nation on the basis of per capita personal income), ranked twenty-ninth, eleventh, and third respectively.

The purposes of this article are to (1) analyze the elements included by The Chronicle of Higher Education in its ranking of States' support of higher education and (2) suggest the best single method to rank the states for comparative purposes, the only reason for ranking in the first place.

THE ASSOCIATION OF PRIVATE ENTERPRISE EDUCATION

The Association of Private Enterprise Education was created in 1974 by educators, many of whom held university Chairs of Private Enterprise or Entrepreneurship and business people committed to furthering economic understanding.

The Association of Private Enterprise Education believes that individual knowledge and understanding of a society based on freedom in enterprise can provide an environment in which people can fulfill their greatest potential. The Association acts as a network. Its members gain information, interaction and support in their efforts to put into action accurate and objective understanding of private enterprise systems.

The purposes of the Association of Private Enterprise Education are to:

1. Promulgate an accurate and objective understanding of America's business system in its many aspects and its various components;
2. Act as an information exchange among those involved with private enterprise and entrepreneurship education, particularly in relation to research, teaching methods, curricula and sources of funding;
3. Advance teaching of and research in the American system of private enterprise;
4. Encourage the creation of college and university programs on private enterprise and entrepreneurship education to assist in making programs more effective;
5. Encourage and offer assistance to businessmen who may serve as visiting lecturers on college campuses; and
6. Encourage dialogue with representatives of other economic systems across the world.

The purposes of the Association are complemented by the following:

College and University Chairs and Centers--The Association has been instrumental in establishing Chairs and Centers of Private Enterprise and Entrepreneurship in colleges and universities, which in turn develop courses and programs reaching tens of thousands of students each year.

Writing--Association members write hundreds of articles and dozens of books each year for business, scholarly and general audiences.

Publications--Newsletters, brochures, monographs and books are published by the Association and its members.

Radio, Television, Films--Members make scores of appearances each year on talk shows, news programs and documentaries.

National Forums and Lecture Series--Members sponsor national forums on critical issues in private enterprise and then publish their proceedings as books.

Teaching Teachers--Members' programs teaching teachers economic understanding and how it can be taught reach thousands of teachers and millions of students each year. Many members have created extensive resource banks of books, periodicals, games and audio visual materials for the use of teachers.

Employee Economic Understanding--Members go into factories, warehouses and offices to provide economic education for blue and white collar employees in union and non-union facilities. Publications and materials are developed for employee economic education programs. Hundreds of thousands of employees are reached each year in this manner.

Professional Economic Education--Members develop special programs for professional audiences--physicians, clergy, lawyers, journalists--to improve their economic understanding and more effectively carry out their roles as community opinion leaders.

Entrepreneurial Programs--Members go to work with entrepreneurs, helping them to start businesses and keep them going. Members have developed and teach entrepreneurship courses in colleges and universities.

Governmental Action--Members serve in advisory capacities to governmental bodies dealing with economic policy, taxation and othere issues on national, state and local levels.

Speaking--Association members make over 2,000 speeches a year to audiences totaling hundreds of thousands.

The mission of the Association of Private Enterprise Education is to put into action accurate and objective understandings of private enterprise. Further, the Association and its members are committed to a future of innovation, productivity and ever improving standard of living for all people.

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The logo of the Association of Private Enterprise Education is a representation of Adam Smith's invisible hand" in which rests the fate of the world. As Smith put it:

> "Every individual endeavors to employ his capital so that its produce may be of greatest value. He generally neither intends to promote the public interest, nor knows how much he is promoting it. He intends only his own security, only his own gain. And he is in this led by an invisible hand to promote an end which has no part of this intention. By pursuing his own interest, he frequently promotes that of society more effectively than when he really intends to promote it."

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